
NIGERIA IN TRANSITION:

Macroeconomic Outlook for the Second Half of 2023

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We are a group of curious and analytic thinkers with expertise in economic and financial research, data analytics, industry analysis, and consulting.

An arm of Kwakol Markets, Kwakol Research works closely with a broad range of clients, including multilateral institutions, institutional investors, foreign missions, corporations, and NGOs, among others. Our team conducts bespoke research and provides exceptional advisory services in business, politics, investments, and development.

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Key industries on which we focus include financial markets, financial technology, natural resources, renewable energy, and key agribusiness value chains.

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Executive Summary



The Nigerian economy faces several challenges as it enters the second half of 2023. These challenges include a slowdown in economic growth, rising inflation, price shocks due to the recent macroeconomic reforms carried out by the Bola Ahmed Tinubu presidency, and a tight monetary policy stance. While the new government is now taking some steps to address these challenges, it is unclear whether these steps will be enough to prevent a recession. There is also an overall slowdown in medium-term growth forecasts by the IMF and the World Bank.

To address these challenges, the federal government must deploy non-monetary policy tools and shrewd supply-side economics to address the supply-side constraints responsible for Nigeria's nagging cost-push inflation. By doing so, the government can help to improve the productivity of the economy and reduce the cost of production, which would help to lower inflation and create a more stable macroeconomic environment for the economy.

This macroeconomic outlook for Nigeria in 2023 is presented in sections. The first section

provides a comprehensive review of the state of the Nigerian economy in 2022 and the first half of 2023. It highlights key causes of Nigeria's challenged economy, including cost-push inflationary pressure, a decline in fiscal performance, tight monetary policy, external vulnerability, and a decline in investor confidence.

The latter parts of the report include the macroeconomic projections for Nigeria in 2023. The projections take into account the key themes identified in the first part as well as the risks that could impact them.

The final section of the outlook presents concrete policy recommendations aimed at tackling the challenges confronting Nigeria and propelling the nation towards a path of economic prosperity.

The macroeconomic outlook and the actionable policy recommendations will guide policymakers in their efforts to achieve sustainable economic growth and shared prosperity for all Nigerians.

01

INTRODUCTION

Introduction



A macroeconomic outlook for the second half (H2) of 2023 has become crucial as Nigeria strives to navigate its challenging macroeconomic environment, especially given that the country has recently ushered in a new administration with major changes to macroeconomic policies.

This period is critical for most Nigerians due to the major shift in the ways policymakers are attempting to address macroeconomic challenges and push the economy toward resilience and prosperity.

The first half of 2023 witnessed the removal of petroleum subsidies and a significant naira devaluation as the government attempted to unify the exchange rates and allow market forces of demand and supply to determine both the price of petrol and the price of the naira.

These policies are consistent with attracting more private investment to the Nigerian economy and reallocating resources toward critical infrastructure development.

An understanding of the macroeconomic landscape in H2 2023 is pivotal for policymakers, businesses, investors, and individuals to make informed decisions and initiate dynamic and effective strategies to adapt to the changes in economic conditions.

By analyzing the distinctive opportunities and unique challenges that are particular to the country, this outlook offers insightful information on Nigeria's economic prospects over the next six months.

The macroeconomic outlook acts as a roadmap for stakeholders, providing insightful information on the prospects, trends, and policy challenges that will influence Nigeria's macroeconomic environment over the forecast period.

Introduction

1.1 Macroeconomic Overview

Economic growth, measured by the growth rate of gross domestic product (GDP), declined in Q1 2023 to 2.31%. This represents a 1.21 percentage point decline when compared to the 3.52% growth recorded in Q4 2022. The decline in growth was largely attributed to the infamous naira policy of the Central Bank of Nigeria (CBN). The policy, which led to a scarcity of cash, dampened demand and production levels, feeding into lower GDP growth.

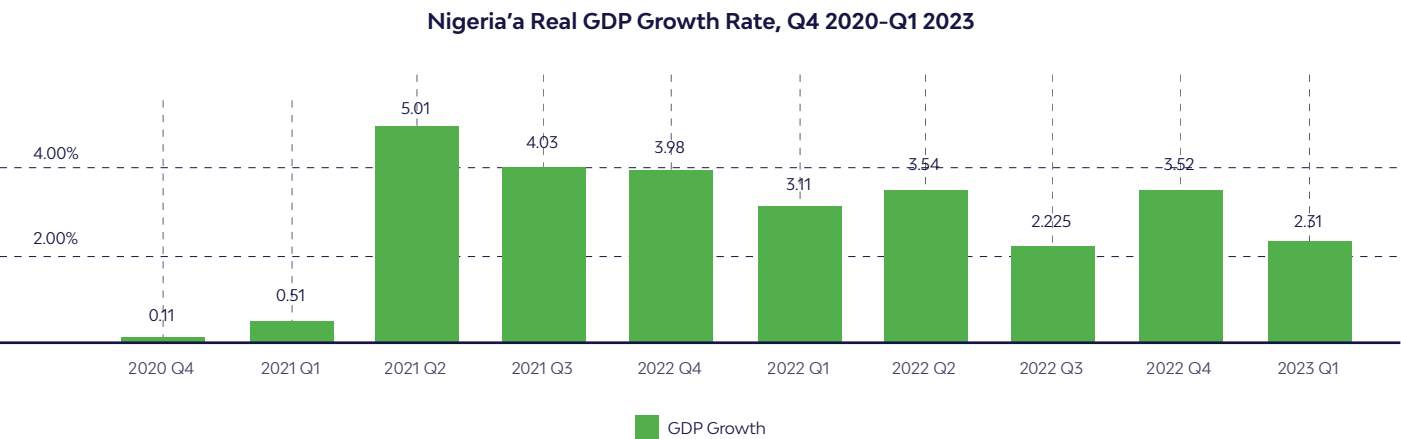


Figure 1: Real GDP Growth Rate, Q4 2020-Q1 2023. Source: NBS (2023).

Growth was driven by the service sector, which grew by 4.35% in Q1 2023. The industrial sector also had positive growth in Q1 2023, which was at 0.31% compared to -0.94% growth in Q4 2022. However, the agricultural sector contracted by -0.90%, compared to its 2.05% growth in Q4 2022.

stood at 28.8%, and youth unemployment was 42.5%. However, data from KPMG revealed higher figures for unemployment in Nigeria, placing the unemployment rate at 37.7% in 2022 and estimated to reach 40.6% by year's end in 2023.

Nigeria's unemployment rate stood at 33.3%, according to the National Bureau of Statistics. The percentage of underemployed Nigerians

Nigeria's Unemployment and Underemployment Rate

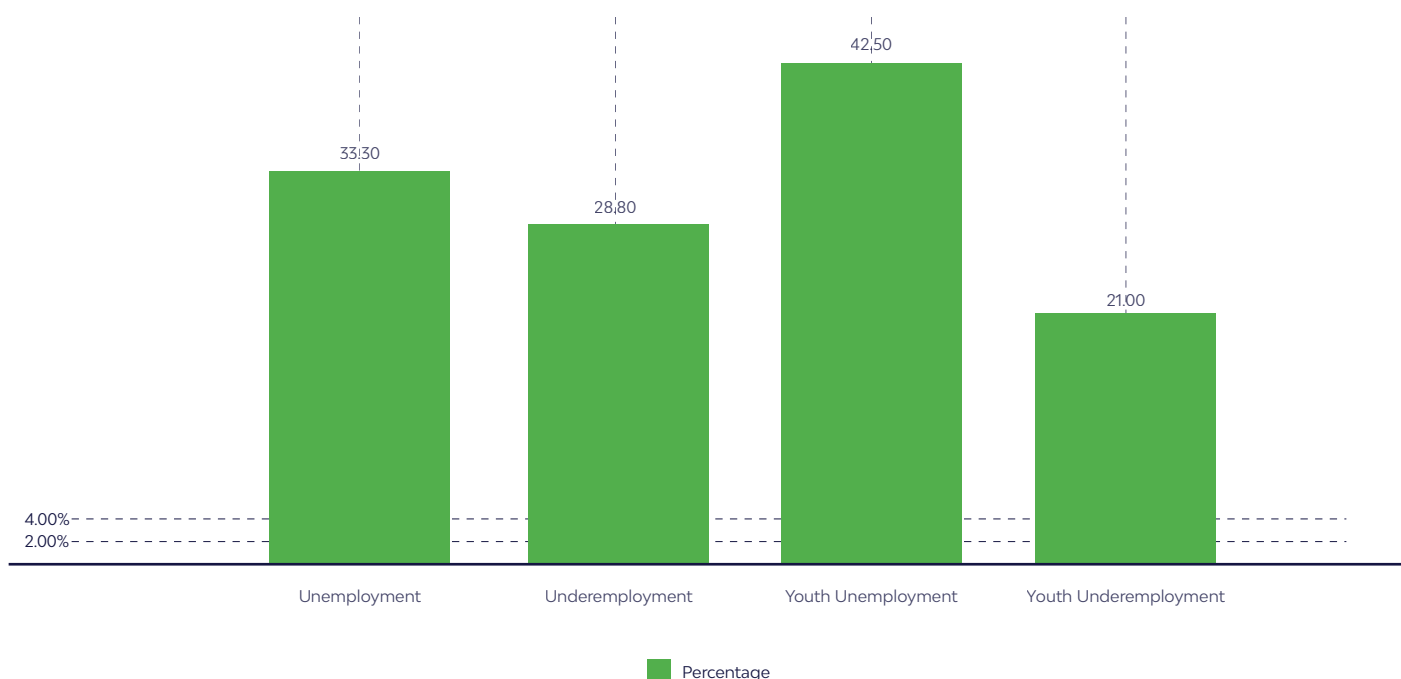


Figure 2: Unemployment and Underemployment Rate
Source: NBS (2023)

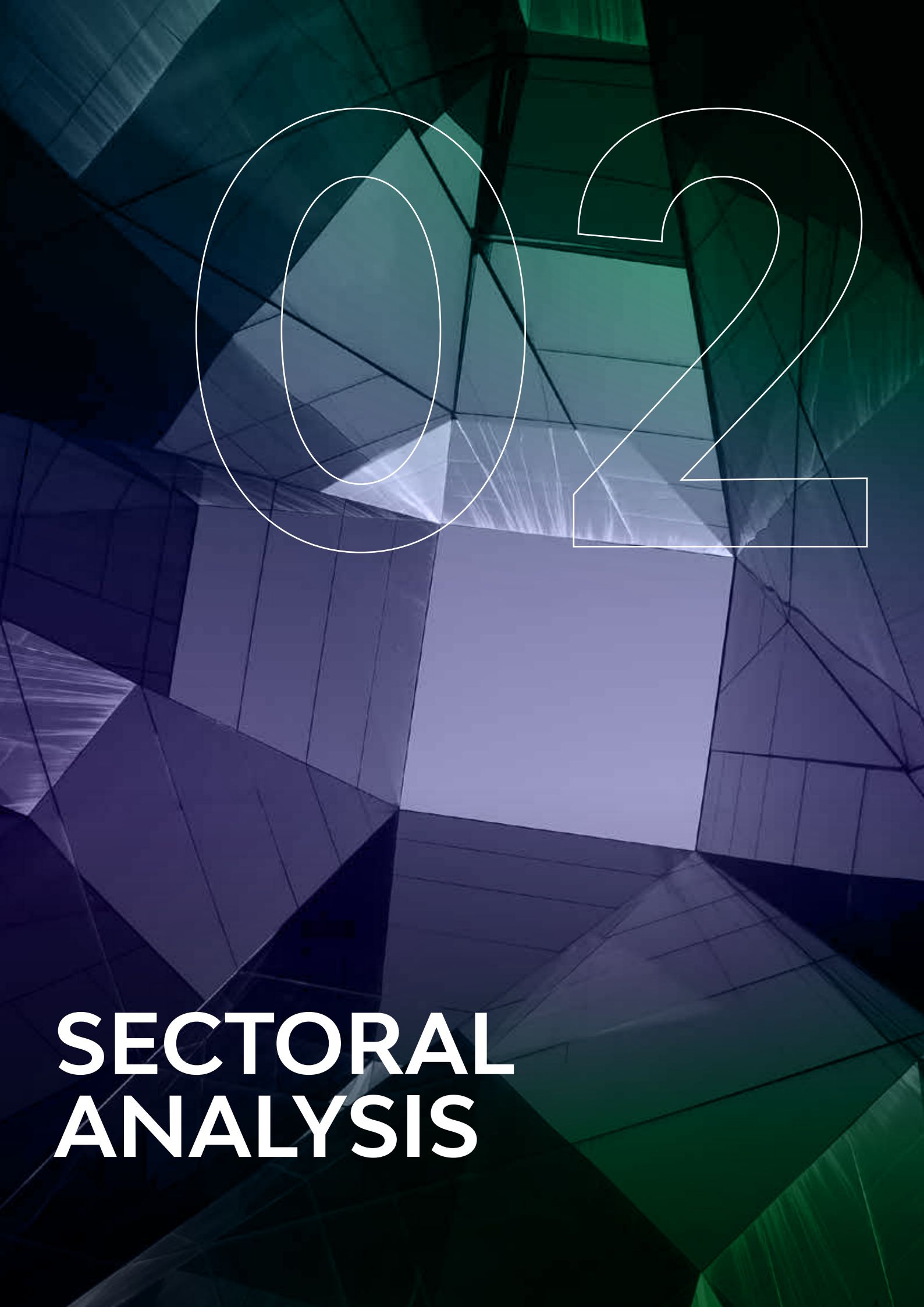
Table 1: End of Quarter Monetary Policy Rate and Inflation Rate (%)

Index	Q4 2020	Q2 2021	Q4 2021	Q2 2022	Q4 2022	Q2 2023
MPR	11.5	11.5	11.5	13	16.5	18.5
Headline Inflation	15.75	17.75	15.63	18.6	21.34	22.79

Source: CBN and NBS (2023). Note: MPR is the Monetary Policy Rate.

The headline inflation rate stood at 22.79% by the end of Q2 2023. There has been a consistent increase in inflation despite the increase in MPR, signaling the weak connection between conventional monetary policies and the inflation

rate in Nigeria. Moreover, the ineffectiveness of demand-pull measures in curbing inflation raises doubts about the continued use of the MPR as a tool for inflation control.



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SECTORAL ANALYSIS

Sectoral Analysis



Nigeria's economic growth endured a slowdown in the first quarter of 2023, a result of heightened political tension in the lead-up to the 2023 elections combined with the Central Bank's infamous naira redesign policy. The policy negatively impacted trade and related activities, with spillover effects on the agricultural and industrial sectors. This was reflected in the relatively lower GDP growth rate for Q1 2023 (2.31%) vis-a-vis figures for Q1 2022 (3.11%) and Q4 2022 (3.52%). However, beyond the aforementioned short-term shocks, key sectors of the Nigerian economy, especially the agricultural and industrial sectors, continue to endure structural challenges.

Sectoral Analysis

2.1 The Agricultural Sector



The Agricultural sector contributes nearly 19.63% to Nigeria's GDP, one of the highest among the nation's sectors. Beyond its economic contribution, the sector ranks as one of the highest employers of labor, especially in the informal sector, and powers significant trade activities in the informal sector.

The agriculture sector also plays an increasing, albeit relatively small, role in Nigeria's external trade, with earnings from key cash crops (cocoa, cashew, ginger, etc.) exceeding US\$1 billion.

While small relative to the oil and gas sector, Nigeria's agricultural sector holds significant potential as a major export revenue earner if key challenges are addressed. The sector's positive performance over the past three years took a negative turn in Q1 2023 as a result of the CBN's naira policy, which crippled trading activities in the rural parts of the country and key food-producing areas.

With a new administration focused on improving agricultural productivity, the sector's relatively positive growth could be sustained and possibly increased if key impediments related to productivity, storage, traceability, and phytosanitary quality assurance are addressed. Furthermore, the threat of large-scale floods in key food-producing areas remains. The Nigerian Meteorological Agency has predicted massive rains and potential floods this year. The new administration's (federal and state) ability to proactively address these dangers would significantly impact the sector's performance this year.

Concerns over insecurity and the ability of farmers to cultivate crops remain. The government's ability to rein in the menace will be a key determinant of the sector's performance in the second half of the year. Overall, the outlook for the agricultural sector remains positive, albeit measured.

Agricultural Sector Growth (%)

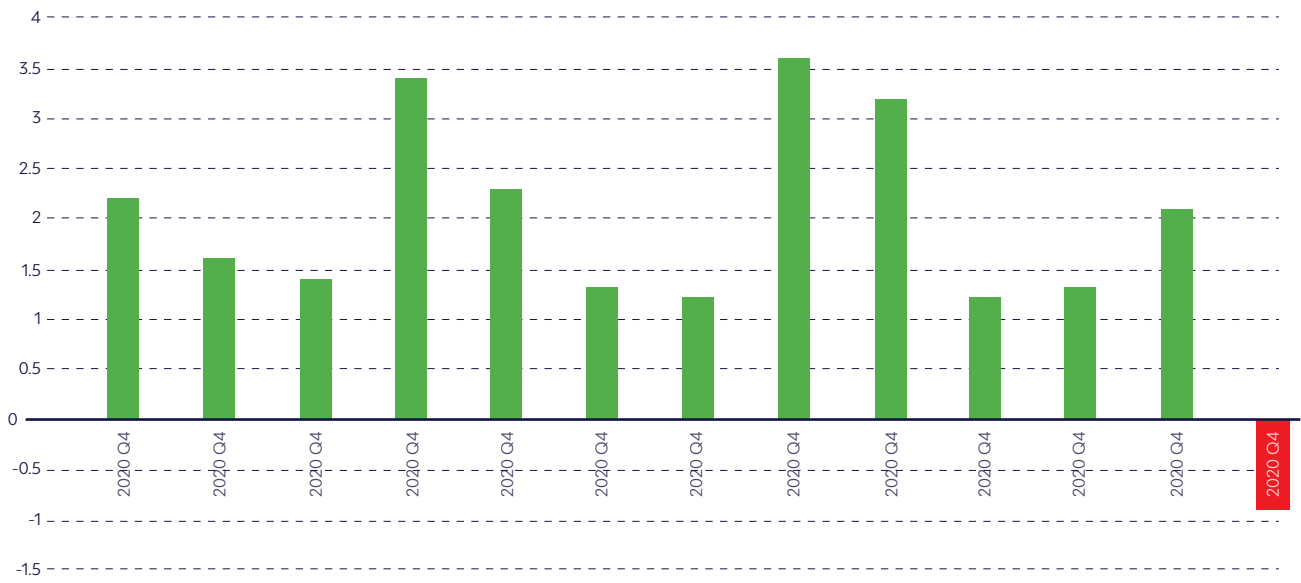


Figure 3: Agriculture Sector Growth (%)
Source: NBS

Sectoral Analysis

2.2 The Industrial Sector



High input costs, forex scarcity, and expensive diesel-powered production continue to hamper the manufacturing sector. In the past thirteen quarters (2020-2023Q1), the sector enjoyed modest positive growth in only three quarters. The most recent was 2023Q1, driven largely by relative improvements in oil and gas production as a result of a slight decline in oil theft in key producing areas.

The prognosis for the second half of the year is measured. Admittedly, the new administration has undertaken a series of key reforms. These include the devolution of energy generation powers to states and decreased bureaucratic

hurdles against captive power production by corporations. Furthermore, the government’s unification of multiple exchange rates and easing of access to forex would significantly benefit manufacturing firms, especially smaller-sized firms, that had been priced out of the central bank’s exchange rate and had to seek forex in the black market. However, notwithstanding these reforms, the expected positive impact of these policies might take time to crystallize. Furthermore, key headwinds remain. Chief among these is the increased likelihood of a recession and the potential for a decline in commodity prices, including oil and gas.

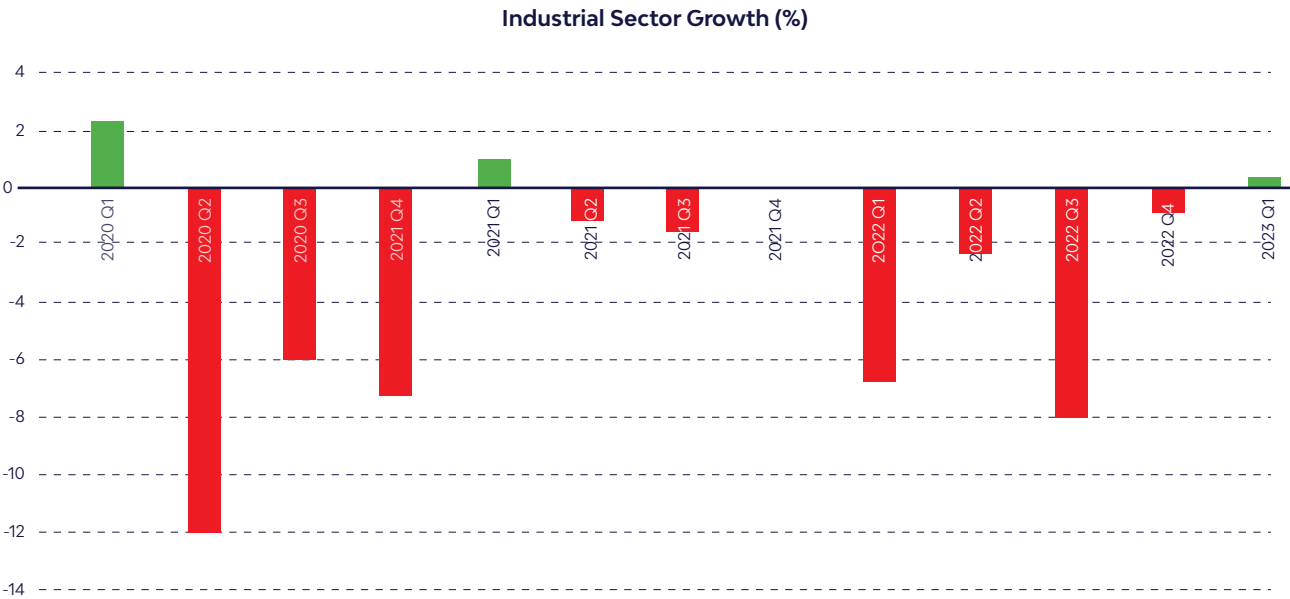


Figure 4: Industrial Sector Growth (%).
Source: NESG

Sectoral Analysis

2.2 The Services Sector

The services sector enjoyed a 4.4% growth rate in Q1 2023, notwithstanding the negative impact of the CBN's controversial policy. While the apex bank's policies negatively impacted trade, other subsectors enjoyed modest growth, including ICT, finance, insurance, and financial technology. However, the above growth figure is the lowest in the past six quarters. The reversal of the CBN's policy and resumption of trade should spur an uptick in growth rate in the second half of the year, barring unforeseen occurrences.

Thus, the prognosis for the second half is positive. Several key factors, including the passage of the Startup Bill, the relaxation of forex trading restrictions, and the suspension of the controversial Naira redesign policy, would significantly boost trade, financial transactions, and other service activities. More so, increased activities in the agricultural and industrial sectors as a result of the aforementioned reforms, if realized, would directly impact demand for activities in the service sector.

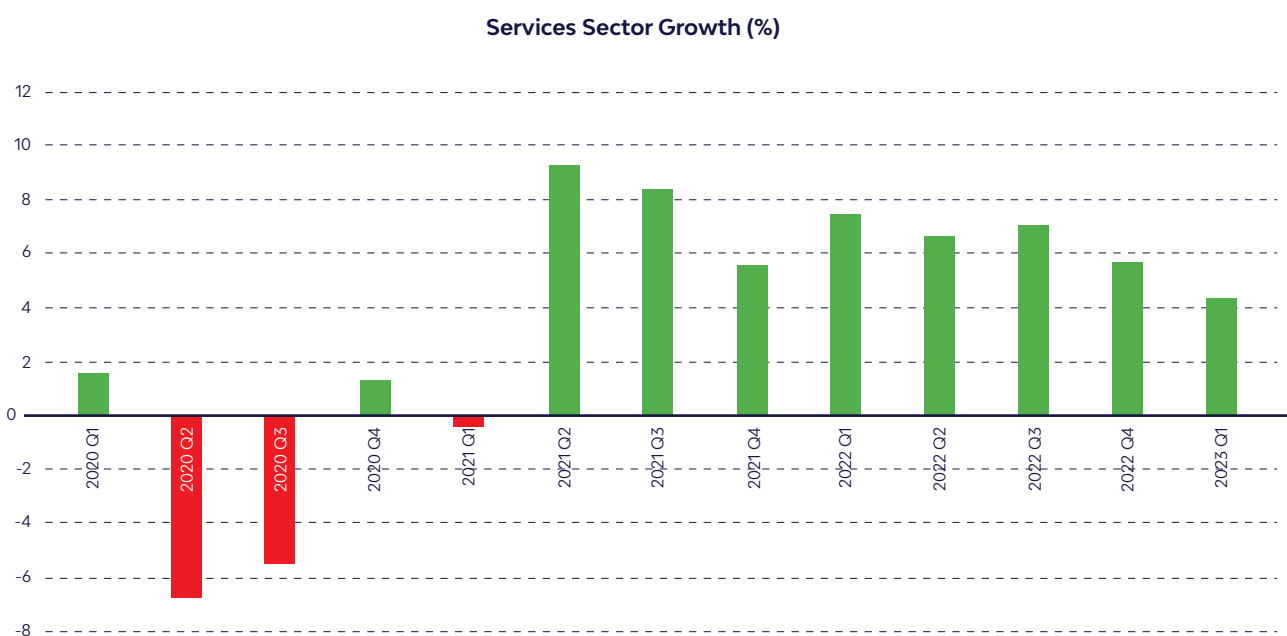



Figure 5: Services Sector Growth (%).
Source: NESG

The background is an abstract composition of overlapping geometric shapes, primarily triangles and polygons, in shades of dark green, teal, and deep blue. A large, white, thin-lined outline of the number '035' is positioned in the upper half of the image. The '0' is a simple oval, the '3' is composed of two curved strokes, and the '5' is formed by a horizontal top bar, a vertical stem, and a curved bottom. The overall effect is modern and architectural.

035

GLOBAL ECONOMIC ENVIRONMENT

Global Economic Environment

The global economic environment continues to exhibit markedly sluggish growth and increased financial and geopolitical risks. While the virulence of the pandemic (and its consequent supply chain woes) has waned, the impact of ongoing geopolitical tensions remains. Economic forecasts from the IMF and the World Bank paint a gloomy picture for the global economy in the short to medium term. From a global growth rate of 3.4% in 2022, the IMF forecasts a decreased growth rate of 2.8% in 2023, with a five-year average growth rate of 3%. Advanced economies are expected to witness a much smaller growth rate, with 2023 figures

estimated at 1.3% compared to 2.7% in 2022.

The key drivers of the global economy are already exhibiting signs of economic stress. Germany is officially in recession, thereby dimming the forecast for EU member countries and the rest of Europe. In Asia, China’s zero-covid experiment significantly impacted the country’s expected post-covid rebound. Notwithstanding its abandonment of the controversial policy, the country’s economic recovery continues to sputter, thus significantly decreasing demand for key commodities from developing countries, including Nigeria

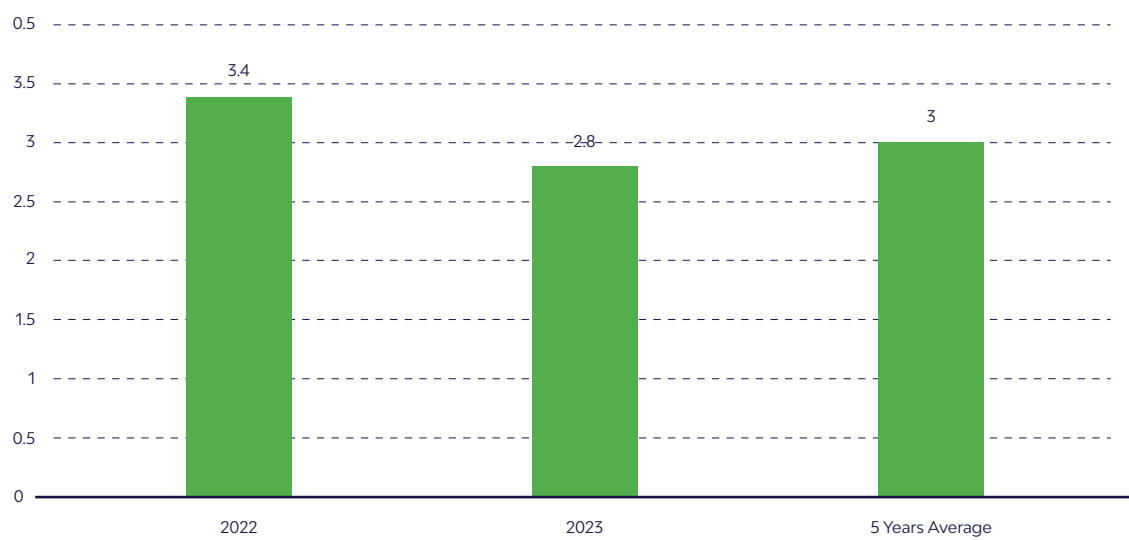


Figure 6: Global GDP Growth Rate (%).
Data Source: IMF Global Economic Outlook

Finally, America’s high inflation rate and the Fed’s relentless attempts at achieving its 2% target have triggered one of the tightest monetary policy regimes in recent American history. This consistent hike in rate has increased the risk of recession, with potential consequences for the global economy. While the job market remains robust, there is no denying the increased cost of borrowing for consumers and businesses, which has negative implications for demand for key import commodities.

For their part, developing countries have borne the brunt of these global developments. Many developing countries, including Nigeria, continue to suffer from a combination of high dollar-denominated debt, decreased revenue, and a volatile exchange rate. This poses significant challenges to the local economy, increases the risk of default, and threatens a breakdown in social cohesion in these countries if key reforms are not implemented.

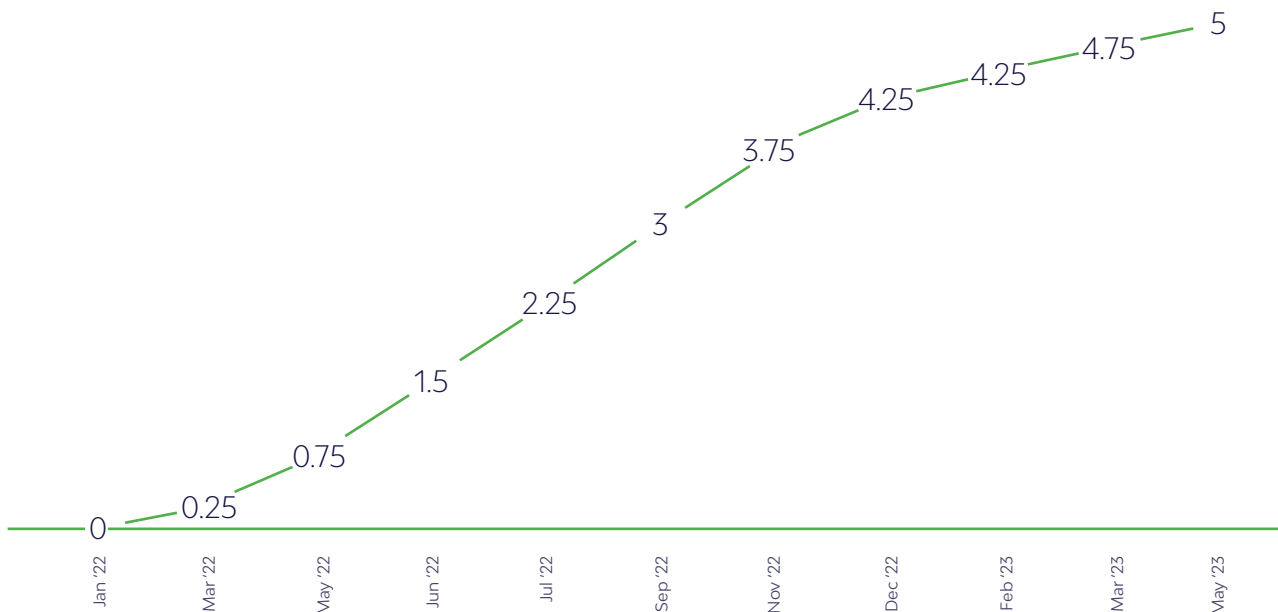


Figure 7: United States Federal Funds Rate (%).
Data Source: Federal Reserve Bank of St. Louis

Beyond the impact of COVID and post-COVID inflation, Key geopolitical developments continue to plague global economic prospects. Russia's invasion of Ukraine has reverberated globally. Considering Ukraine's and Russia's role as one of the world's key food baskets, the war (and Western sanctions on Russia) have significantly increased the cost of key commodities, including wheat, corn, fertilizer, and barley, among others. More so, the war's continuation creates continued uncertainties, as demonstrated by the near descent into civil war as a result of the Wagner Group's threat of a march on Moscow and the sudden spike in key commodity prices. These uncertainties pose short-term risks to the global economy, with a direct impact on local consumers as subsidies and other cushions are increasingly dismantled in Nigeria.

In addition to the Russian war, key geopolitical flashpoints with potential global consequences include the China-Taiwan crisis, Iran's Nuclear Program, and North Korea, among others. Furthermore, key challenges across the continent pose risks of varying impact. Sudan's civil war between key army factions continues to fester with potential spillover effects in the form of humanitarian crises and/or illegal weapons spillovers. Others include various terrorism activities across West Africa and other parts of the Sahel. These geopolitical and continent-level uncertainties could impact the Nigerian economy in the form of commodity price spikes, potential threats to commodity transport in key waterways, and decreased demand from major partner countries, among others.

04

MONETARY AND FISCAL POLICY OUTLOOK

Monetary and Fiscal Policy Outlook

4.1 Monetary Policy Outlook

The major policy tool of the CBN in controlling price levels is the MPR. The CBN has raised the MPR consistently in its bid to stall the growth of inflation. MPR increased from 11.5% at the end of Q4 2020 (December) to 16.5% at the end of Q4 2022 (December). Currently, the MPR is 18.75%, with an asymmetric corridor of +100/-300 basis points around the MPR. The Cash Reserve Ratio (CRR) stands at 32.5% and the Liquidity Ratio at 30%.

Table 2: Monetary Policy Tools (MPR, CRR, and Liquidity Ratio), %, June 2023

MPR	CRR	Liquidity Ratio
18.75	32.5	30

Source: CBN

The Central Bank of Nigeria (CBN) has been implementing a contractionary monetary policy in response to the upward trend in inflation. However, despite these efforts, inflation has remained persistent. Notably, there appears to be a co-movement between the Monetary Policy Rate (MPR) and inflation, raising questions about the effectiveness of conventional monetary policy tools.

It is expected that the CBN will continue to utilize the MPR as a means to combat inflation in H2 2023. If inflation persists, there may be a further increase in the MPR. However, the CBN must recognize that solely relying on the MPR to address inflation without addressing underlying supply-side constraints in the economy may have unintended consequences.

Increasing the MPR restricts the availability of credit within the banking system, which in turn

limits borrowing capacity for the private sector. This could hinder productivity and economic growth. Therefore, it is important for the government to simultaneously address supply-side constraints, such as improving infrastructure and addressing bottlenecks in production, to complement the CBN's efforts in effectively controlling inflation.

The new government administration at the federal level has undertaken monetary policy reforms that include allowing the naira to float freely and aiming to unify the exchange rate with the parallel market. As part of this reform, CBN has eliminated the multiple exchange rate windows that were previously in place and consolidated them into the Investors and Exporters (I&E) window, which is based on business activities. Although the exchange rate

has not been fully unified yet, the reform has significantly reduced arbitrage opportunities, and the official exchange rate is approaching closer alignment with the parallel market rate.

Implementing a floating exchange rate regime can contribute to greater stability in the balance of payments and facilitate unrestricted access to foreign exchange, thereby enhancing overall efficiency. However, Nigeria is susceptible to significant fluctuations in the exchange rate, leading to heightened volatility. This volatility exacerbates existing economic challenges such as supply-side inflation and unemployment. These challenges are primarily driven by the country's heavy reliance on imported consumer and producer goods and the dominance of crude oil in our export earnings, which further contributes to inflationary pressures.

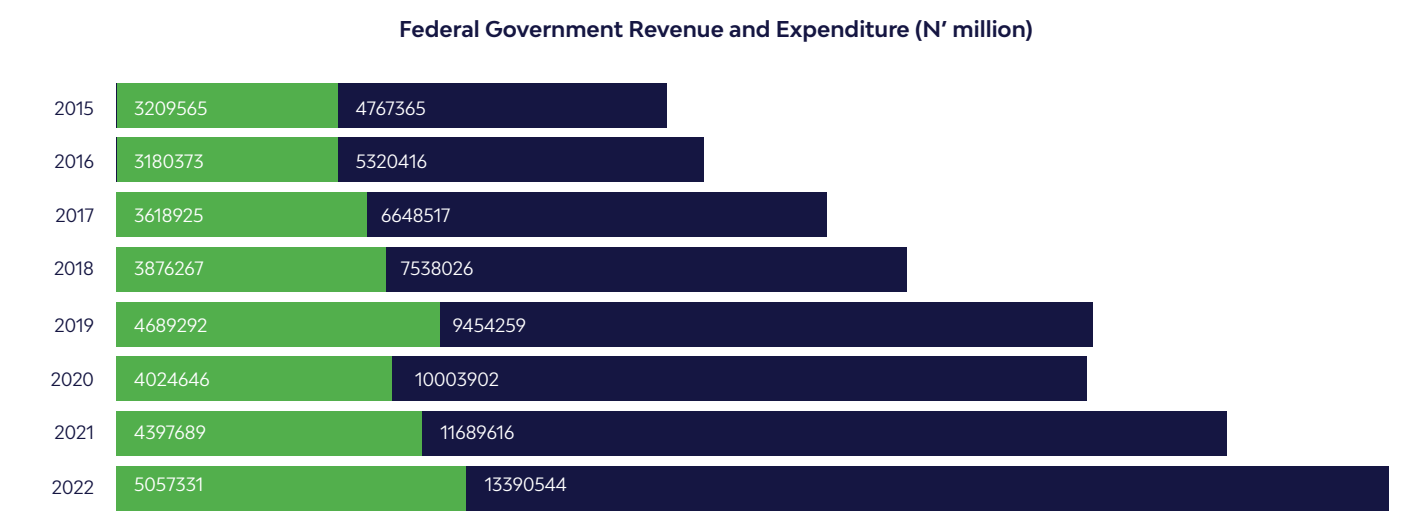
The recent monetary policy reforms have included the discontinuation of the RT200 rebate and Naira4Dollar remittance schemes. These

initiatives were aimed at promoting non-oil exports and encouraging diaspora remittances to increase foreign exchange inflows.

Looking ahead to H2 2023, monetary policy is expected to remain consistent with its existing stance. The CBN will continue to prioritize the battle against inflation amid a flexible exchange rate regime using the MPR. The pursuit of attracting foreign portfolio investments (FPI) contributes to the CBN's stance on the MPR, aimed at boosting the influx of dollars into the Nigerian economy. However, the CBN must ensure targeted access to credit for the production sector by employing unconventional monetary policy. It is important that the CBN strive to avoid excessive restrictions on the private sector's access to credit, as this would further dim economic growth. It is expected that H2 2023 will see the MPR hover around its existing value of 18.75% as further increases could constrain economic activities.

Monetary and Fiscal Policy Outlook

4.2 Fiscal Policy Outlook



Source: Accountant General of the Federation/CBN. Figure 8: Federal Government Revenue and Expenditure (N' million)

The Buhari-led federal government implemented budget deficits as part of its efforts to enhance critical infrastructure and stimulate economic growth. Over the years, government expenditure has shown a consistent growth trajectory, rising from N4.76 trillion in 2015 to N13.39 trillion in 2022. This represents a substantial increase of over 280% in government spending. However, government revenue has experienced more modest growth of just over 50%, from N3.21 trillion in 2015 to N5.06 trillion in 2022. As a consequence, **there has been a persistent rise in the fiscal deficit, which reached N8.33 trillion in 2022.**

Federal Government Fiscal Deficit (N' million)

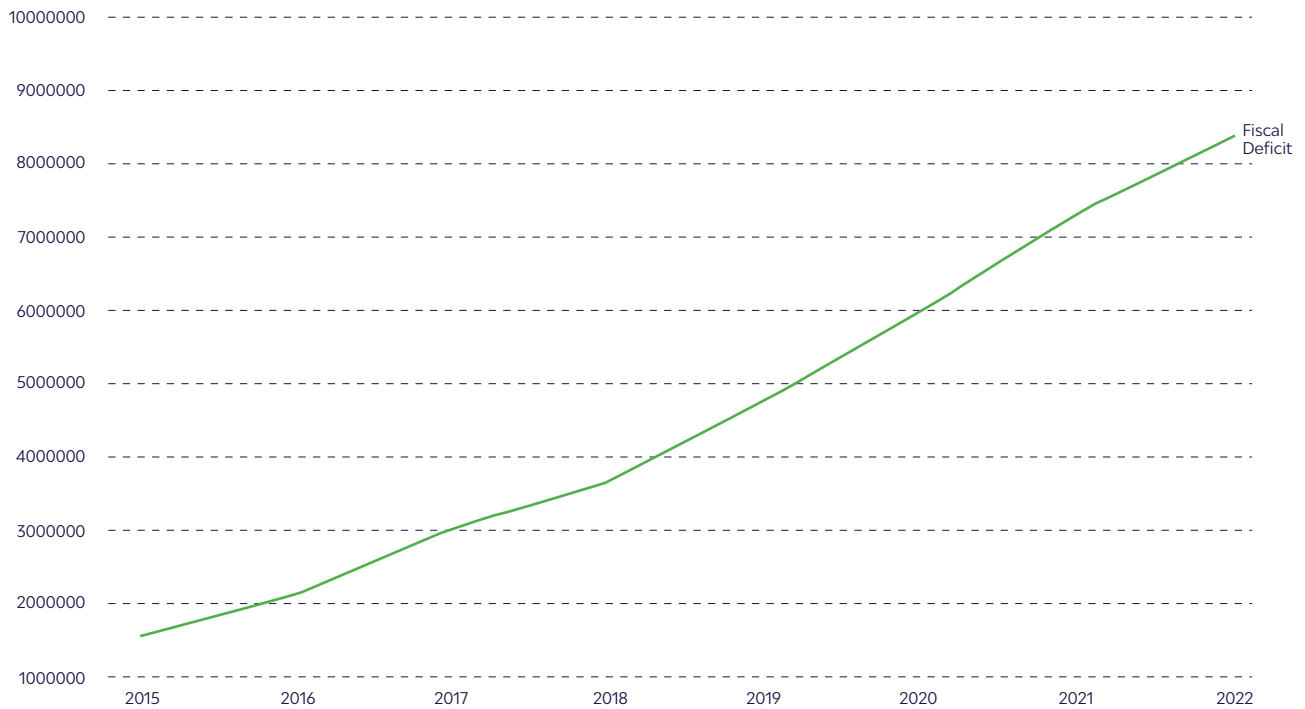


Figure 9: Federal Government Fiscal Deficit (N' million). Source: Accountant General of the Federation/CBN

Quarterly Federal Domestic Debt Stock (N' million)

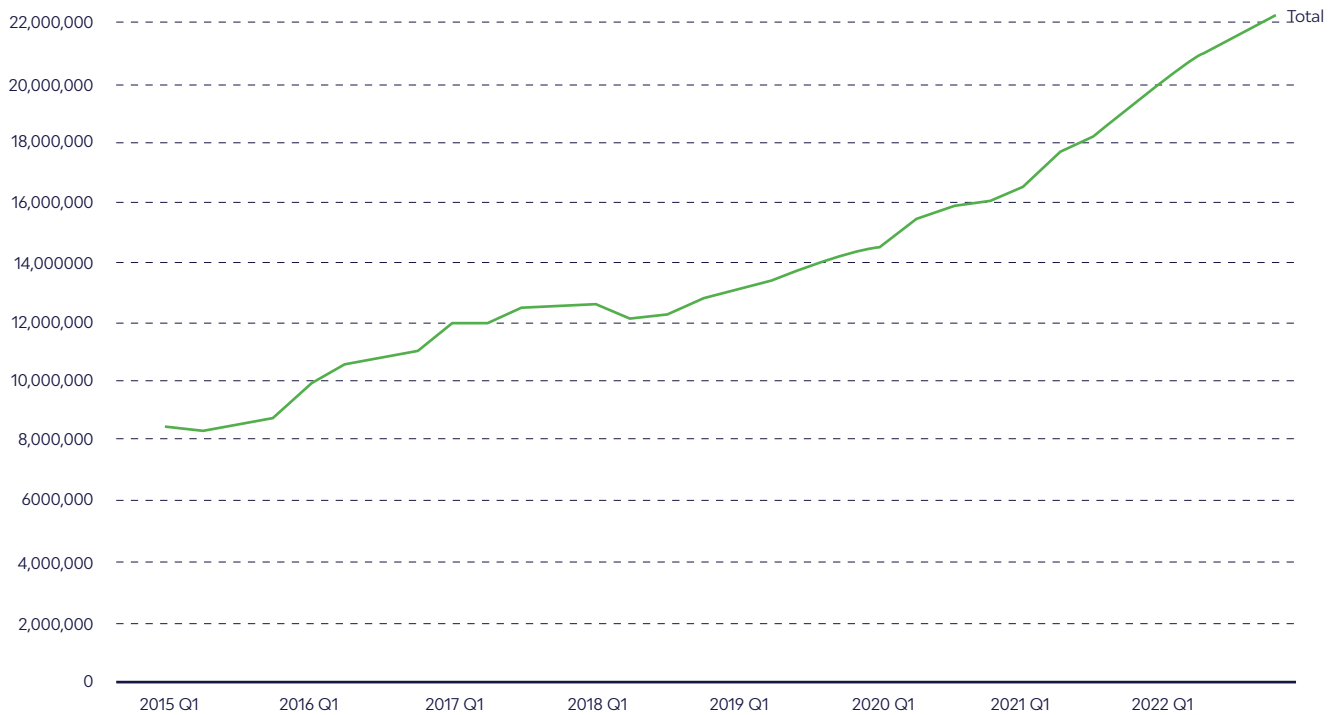


Figure 10: Quarterly Federal Domestic Debt Stock (N' million). Source: Debt Management Office/CBN

By the end of Q4 2022, the federal government's domestic debt had reached N22.2 trillion. This represents a substantial increase of over 250% compared to Q1 2015 when the debt stood at approximately N8.51 trillion.

Furthermore, when considering the total government debt, which includes both the federal government's debt as well as the debts of the states and the federal capital territory (FCT), the amount was N46.25 trillion in Q4 2022. This demonstrates a significant rise from N19.15 trillion in Q1 2017. These figures highlight the substantial increase in government debt over the years, emphasizing the need for prudent debt management and strategies to ensure sustainability and fiscal stability.

In the latter part of the first half of 2023, a value-added tax (VAT) of 7.5% was implemented on vehicle gas oil, commonly known as diesel. While this move is expected to bolster the federal government's revenue, it will also lead to elevated manufacturing expenses. Consequently, this will likely translate into higher prices for consumers and contribute to increased inflationary pressures.

In the second half of 2023, it is expected that there will be a reduction in the growth rate of federal government debt in Nigeria. This reduction would be largely attributed to the removal of fuel subsidies, which had been consuming a significant amount of funds. In the first half of 2023 alone, these subsidies amounted to N3.35 trillion.

The Nigerian tax system has also faced inefficiencies, which have posed challenges to revenue mobilization. The government, recognizing this issue, intends to address it in the second half of 2023. Significant tax reforms are

expected to take place during this period, aiming to harmonize tax regimes across the country. The ultimate goal of these reforms is to make the tax system more efficient, thereby improving government revenue generation.

By implementing tax reforms and enhancing the efficiency of the tax system through the modernization of tax administration systems and technology, the government can increase revenue and, consequently, reduce its reliance on debt financing. These measures are intended to contribute to the overall reduction of federal government debt during the second half of 2023.




From Kwakol Research Glossary

What is Fiscal Policy?

Fiscal policy refers to the government measures deployed to influence the economy. These measures include but are not limited to taxes and government spending.

A government can decide to influence the macroeconomic conditions of the entity it governs to respond to a recession by increasing government spending in select sectors of the economy and reducing personal taxes as incentives to increase economic activities and domestic consumption that activates the economy towards recession recovery. These measures concisely explained describe what a fiscal policy is.



05

LABOUR MARKET ANALYSIS

Labour Market Analysis



The Labor Market in Nigeria is a major driver of the economy. In 2022, the labor force in Nigeria was estimated at 73.2 million people, or about 34.2% of the total population, according to the World Bank. In Nigeria's most recent employment statistics by Nigeria's National Bureau of Statistics (NBS), 33.3% of Nigerians of employable age are unemployed. The underemployment rate is estimated to be 22.8%, while the youth unemployment rate is 42.5%¹. With a new methodology for computing Nigeria's labor force statistics already announced for deployment in the second half of 2023, we expect these unemployment and underemployment rates to significantly decrease.

The labor market is significant for Nigeria's economy in several ways. First, it is a major source of income for households. According to the most recent estimates of the living wage per individual in Nigeria in 2020, the average living

wage per individual in the country is N43,200². This means that the labor market provides a significant source of income for millions of households.

Second, the labor market is a significant source of government revenue. At least 12% of Nigeria's tax revenues in 2020 came from personal income taxes (PIT) and another 12% of Nigeria's tax revenue in the same year emanated from social security contributions. This proves that the Labour Market in Nigeria is a major contributor to the government's ability to fund public services, highlighting its significance.

Third, the labor market is a major driver of economic growth. When people are employed, they have more money to spend, which stimulates the economy. Labor is also an essential input in the production of goods and services, which contributes to GDP growth.

¹ Nigeria's most recent unemployment statistics by the National Bureau of Statistics (NBS), 2020 <https://www.nigerianstat.gov.ng/>. With the new labor force statistics methodology that the statistical organization is adopting and deploying later in H2 2023, expect the numbers to be significantly lower.

² The Living Wage per Individual in Nigeria increased to 43200 NGN/Month in 2018 from 41800 NGN/Month in 2015 according to estimates by WageIndicator Foundation as presented by Trading Economics: <https://tradingeconomics.com/nigeria/living-wage-individual>.

Nigeria's Labour Participation Rate (2015-2022)

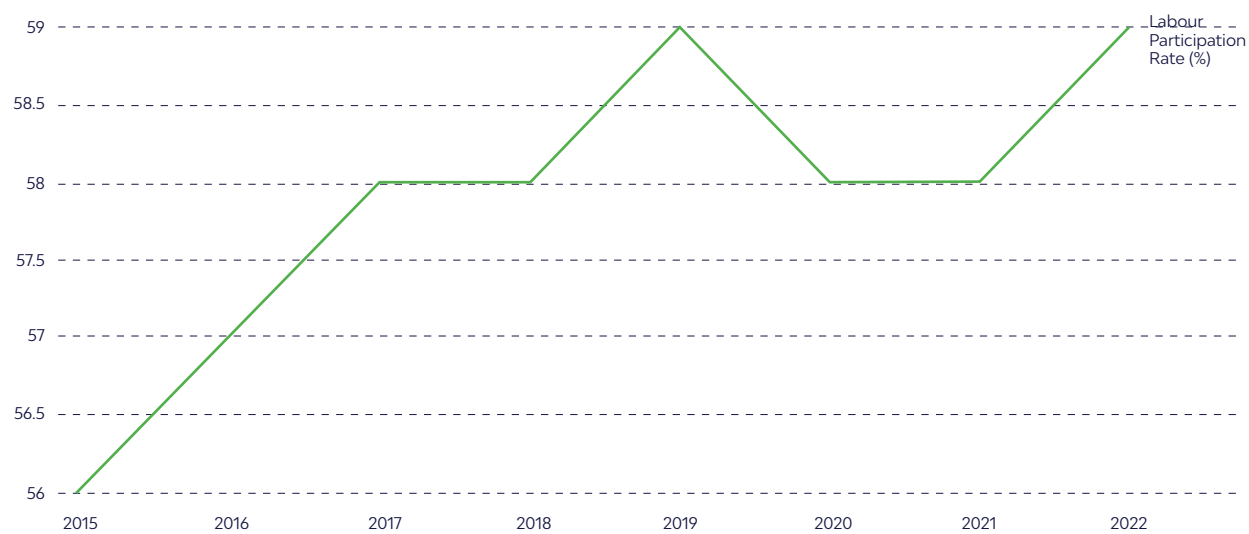


Figure 8: Nigeria's labor Participation Rate has hovered between 56% and 59% since 2015, according to the World Bank.

Labour Market Analysis

5.1 New Labour Force Statistics Trends

In April 2023, the National Bureau of Statistics (NBS) of Nigeria announced a new methodology for computing the country's unemployment rate. This new methodology is based on the resolutions of the 19th International Conference for Labor Statisticians (ICLS) by the International Labour Organization (ILO), which has a broader scope for labor force statistics.

One of the most significant changes under the new methodology is that the working age will be extended to anyone above 15 years, as opposed to the previous limit of 18 years. This means that the working population in Nigeria will increase significantly. Additionally, the definition of employment has now been changed to include anyone who works at least one hour per week, as opposed to the previous requirement of working at least 20 hours per week. This means that Nigeria's unemployment rate will reduce significantly.

Employment		
Changes	Changes	New Methodology
Sample Size	33,300	35,250
Data collection	Quarterly	Weekly
ILO adoption	13th ICLS resolutions	19th ICLS resolutions
Working age/Working population	15-64 years	15 years and above
Employment	Working 20 hours and above weekly	Working 1 hour a week and above
Underemployment	Worked between 20-39 hours	Worked between 1-39 hours. Individuals willing and available for more work.
Umeemployment	Worked below 20 hours or not at all. Individuals actively seeking and available for work.	Worked 0 hours. Individuals actively seeking and available for work.

Sources: National Bureau of Statistics (NBS) and Stears Insights

The implications of these changes are significant. The new methodology will likely drastically reduce Nigeria's unemployment and underemployment statistics. This could have several consequences for policy making. For example, it could lead to a reduction in government spending on job creation programs. Additionally, it could create the illusion that the unemployment problem in Nigeria has gone

extinct, which could lead to complacency among policymakers. Indeed, the new methodology for calculating Nigeria's unemployment rate is expected to exert a considerable influence on policy making and policy outcomes in the country. Being aware of these implications is crucial to ensure that effective and well-informed policies are

implemented. By understanding the potential consequences, policymakers can make informed decisions that address the real challenges of unemployment and underemployment in Nigeria, rather than being misled by a potentially distorted perception of the situation. Sound policies that take into account the true employment scenario can better serve the needs of the population and contribute to sustainable economic growth and development.

What will H2 2023 look like?

The Labor Market in Nigeria is expected to see some significant changes in H2 2023 as a result of the new methodology for computing labor force statistics (unemployment rates), as well as the full removal of fuel (PMS) subsidies, the devaluation of the Naira, the new levy on diesel, and the purported (now disputed) 40% increase in electricity tariffs.

The new methodology for computing unemployment rates is expected to reduce the unemployment rate in Nigeria significantly. This is because the new methodology will include a larger working-age population and a broader definition of employment. As a result, the unemployment rate is projected to fall from 33.3% in H1 2023 (as was last reported in 2020) to around 15% in H2 2023 - Stears Insights is even predicting a 5% unemployment rate for Nigeria with the deployment of the new methodology. The full removal of subsidies on PMS (fuel) will impact public welfare and hurt the Labor Market. Higher fuel prices will increase the cost of living and lower the standard of living for Nigerians. As seen in the fallout of the naira redesign policy, a substantial number of businesses with low resilience can collapse under the weight of such shocks, leading to job losses and reduced economic activity.

The devaluation of the Naira is expected to have a negative impact on the Labor Market. It will make imports more expensive, which could lead to job losses in the manufacturing sector.

The implementation of a 7.5% VAT on diesel is anticipated to adversely affect the Labor Market by escalating production costs and imposing a burden on businesses, particularly in the manufacturing sector. As a result, companies may face difficulties sustaining operations, potentially leading to downsizing and job losses in the manufacturing and processing industries. Additionally, the 40% increase in electricity tariffs is likely to compound the negative impact on the Labor Market, driving up business expenses and production costs, further exacerbating the risk of job losses across various sectors.

Additionally, the introduction of VAT taxation for the informal sector through the FIRS-MATAN collaboration could result in increased costs for traders, potential price hikes, reduced consumer demand, business downsizing, and job losses in the informal labor market in Nigeria. Additionally, it may trigger shifts and challenges in the overall labor market as workers and businesses respond to the new tax regime. The Nigerian Federal Government plans to enhance tax revenues by targeting the informal economy, aiming to tax market traders through a partnership with the Market Traders Association of Nigeria (MATAN), which claims to have around 40 million members. This collaboration will utilize unified systems technology for the collection and remittance of VAT from the traders.

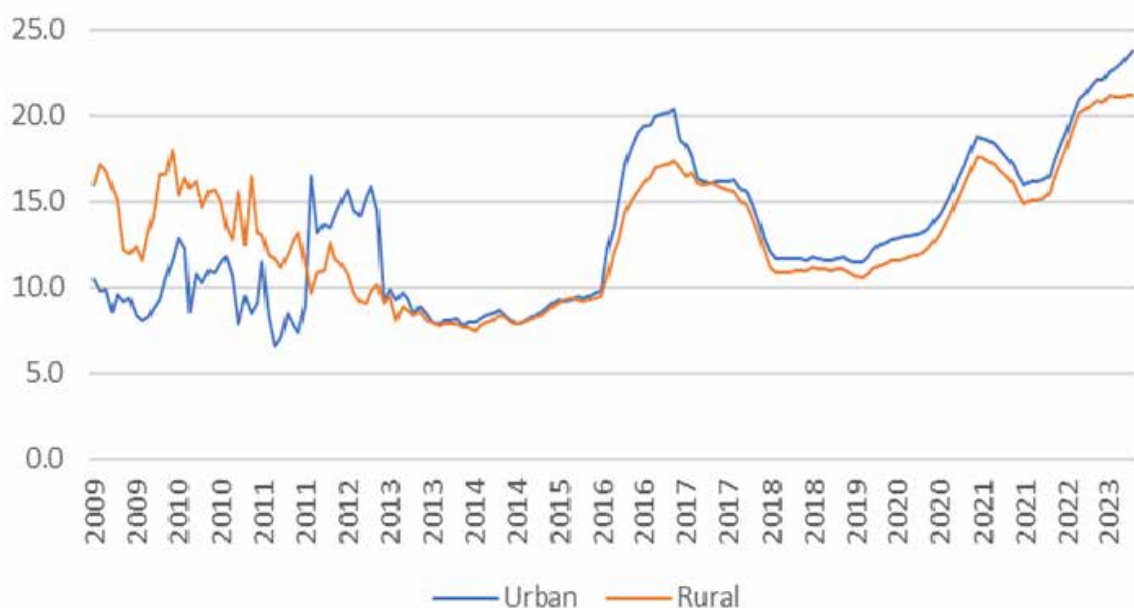
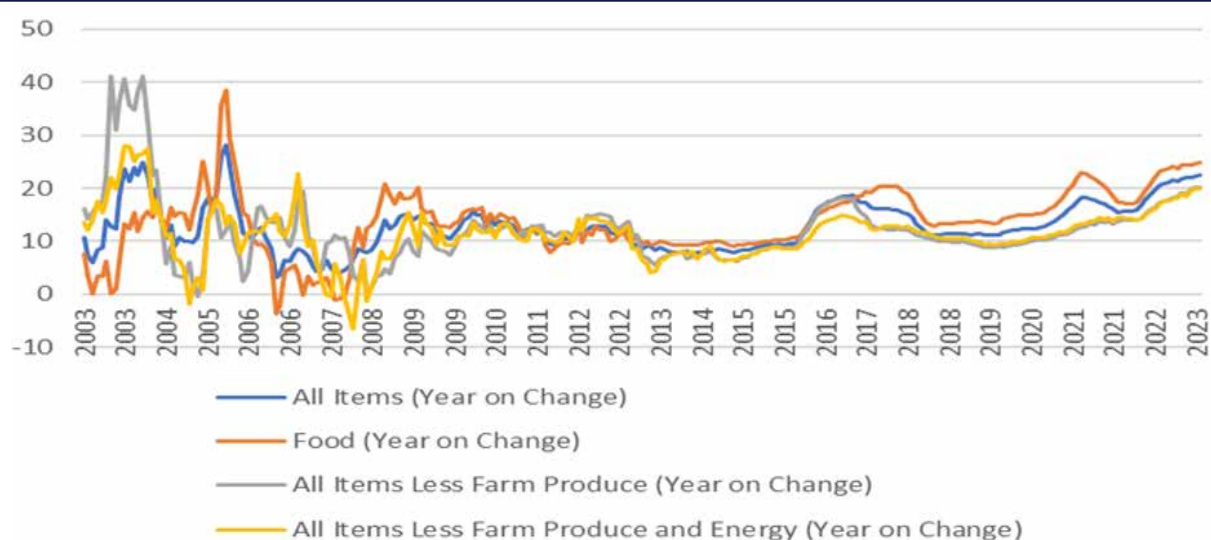
The overall impact of these changes on the Labor Market in Nigeria will be negative. It is clear that the Tinubu presidency's economic policies are likely to have a significant negative impact on the lives of millions of Nigerians in the second half of the year.

065

INFLATION AND PRICE TRENDS

Inflation and Price Trends

Inflation holds a crucial position within the Nigerian economy as it affects consumer purchasing power, investment choices, and overall economic stability. As of June 2023, the inflation rate stood at 22.79%, marking the highest level since September 2005. Notably, food inflation surpasses the headline inflation rate, reaching 25.25% in June 2023.



Since 2015, urban inflation has consistently exceeded rural inflation due to several factors. These include variations in consumption patterns, disparities in market structure and competition, and variances in infrastructure and transportation costs.

While the CBN has continued to adopt conventional monetary policies to mitigate the rise in inflation, inflation has continued to be persistent. This is primarily because the Nigerian inflation problem is supply-side inflation, which has continued to emanate from forces that are largely independent of the MPR.



From Kwakol Research Glossary

What is Inflation?

Inflation is the general increase in the prices of goods and services in an economy.

This means that the purchasing power of money falls. The opposite of inflation is deflation. This is when we see a general fall in prices or an increase in the purchasing power of money.

Nigeria's inflation is mainly measured by the National Bureau of Statistics (NBS). Headline inflation (Headline Index) is the raw inflation figure reported by the NBS monthly. The NBS classifies consumption and then measures them for the Consumer Price Index through the 12 classifications of individual consumption by purpose (COICOP).

Inflation and Price Trends

6.1 Key Contributors to Inflation in Nigeria

Several factors feed into the inflation rate in Nigeria, including exogenous shocks such as the Russia-Ukraine war and increasing energy prices. Exchange rate depreciation in the parallel market and the border closure of 2019 also continue to feed into inflation in Nigeria.

■ Exogenous Shocks

Following the invasion of Ukraine by Russia, energy prices spiked. Between February 2022 and August 2022, there was a 15.3% increase in WTI crude oil prices. The rise in crude oil prices was largely due to sanctions on Russian oil, which reduced global supply. The rise in crude oil prices fed into the prices of petroleum products. According to the Manufacturing Association of Nigeria, energy accounts for 40% of production costs. The increase in crude oil prices increased the cost of production, leading to an increase in the prices of commodities.

The war in Ukraine has also disrupted global trade flows and supply chains, resulting in a drop in global trade. The supply of essential commodities such as wheat has witnessed a decline, as Ukraine is one of the largest exporters of the product globally. Between 2018 and 2020, 12% of Africa's wheat imports were from Ukraine. The shortfall in supply to Africa has increased the price of wheat and associated products such as bread. This has fed into the inflation numbers in Nigeria and is likely to continue, as they are largely exogenous to government short-run policy tools.

■ Exchange Rate

Nigeria is heavily reliant on international trade for consumer and producer goods. In Q4 2022, the value of Nigeria's imports stood at \$11.79 billion. The significant dependence on imports makes prices in the economy vulnerable to fluctuations in exchange rates. The high demand for foreign exchange to cover imports further strains the naira against the dollar, contributing to inflationary pressures.

■ Fuel Subsidy

The Nigerian government has recently removed the fuel subsidy. The removal of fuel subsidies has resulted in an increase in fuel prices, which has had a spillover effect on other sectors of the economy. There has been an increase in transportation costs, production costs, and an overall increase in the cost of living. The rise in fuel prices will see a persistence of inflation in Nigeria in the short to medium term.

■ Border Closure

In August 2019, the federal government closed Nigeria's land borders in a bid to boost local demand for agricultural products, particularly rice. This policy,

however, only resulted in an increase in food prices, which led to a substantial welfare loss for many Nigerians. Food inflation has significantly increased, from 13.7% in August 2019 to 25.25% in June 2023. While the increase in food prices is not only attributable to the border closure, it also contributes to it. This is because the closure of Nigeria's land borders reduced the aggregate supply of food items in the Nigerian market, meeting existing demand, which only led to an

increase in prices. Due to nominal rigidity, it would take only a substantial increase in agricultural aggregate supply for the food price level to decline.

Data from the World Bank (2023) revealed that the growth rate in the agricultural sector declined from 2.4% in 2019, to 2.2% in 2020, and 2.1% in 2021, revealing a decline in agricultural productivity.

What will H2 2023 look like?

Inflation will continue to be persistent in H2, 2023. This is because of its supply-side nature, which is largely exogenous to monetary policy. The implementation of the 7.5% tax on diesel will also contribute to the H2 inflation rate, as will the removal of fuel subsidies. Inflation will continue to creep up in the foreseeable future due to these factors.

The background is an abstract composition of overlapping, translucent geometric shapes in various shades of green and blue. A large, white outline of the number '07' is positioned in the upper half of the image, with the '0' being significantly larger than the '7'.

07

FINANCIAL MARKET OVERVIEW

Financial Market Overview



The financial market in Nigeria demonstrated a positive performance during the first half of 2023, driven by investor optimism, particularly in the Banking, Industrial Goods, and Oil and Gas sectors.

In the first half of 2023, the Nigerian stock market experienced a bullish performance, with the All-Share Index (ASI) crossing the significant threshold of 60,000 index points to hit an all-time high of 60,108.86 index points on Tuesday, June 27th, 2023. Several macroeconomic reforms and increased investor confidence in the nation's economic prospects have contributed to this boom, which has reached its highest point in more than 15 years. This strong market performance has been greatly influenced by President Bola Tinubu's economic policies, notably the managed floating of the Naira on the Investors and Exporters (I&E) Foreign Exchange Window.

In addition, the removal of the fuel subsidy contributed to the impressive performance of the Oil and Gas sector, which witnessed a substantial return of 2.97% on a week-on-week

basis. Investor interest was particularly focused on oil marketing companies, leading to increased patronage. Furthermore, the Industrial Goods sector experienced capital appreciation, with companies like WAPCO and DANGCEM recording significant gains of 2.30% and 1.23% respectively.

Regardless, the Nigerian banking sector is expected to face challenges in H2 2023. The main reason for this is the rising number of non-performing loans (NPLs), which are expected to continue to increase. It is, however, important to note that as of December 2022, NPLs in the country's banking sector had declined further below the regulatory benchmark of 5% to 4.2%. Additionally, rising interest rates will make it more difficult for banks to make profits. This is because the combination of higher borrowing costs, reduced loan demand, increased provisions for bad loans, and other economic implications of rising interest rates will significantly challenge banks' ability to generate profits in a high-interest-rate environment.

Financial Market Overview

7.1 Stock market and Banking Sector



In the first half of 2023, the local equities market in Nigeria demonstrated a positive showing, with the stock market exhibiting resilience and attracting investor attention. Key sectors such as Industrial Goods, and Oil and Gas contributed to the overall positive sentiment.

The Banking sector also witnessed a higher closing, as buying interest was observed in stocks like Zenith Bank. Despite the bullish performance in the first half of the year, the financial market is expected to face challenges, potentially leading to increased volatility in the

second half of 2023. **Notable gains in stocks such as MTN, Zenith Bank, and GTCO have buoyed the stock market's strong performance, further boosting overall investor confidence.** With gains in major blue-chip stocks and an impressive year-to-date return of 18.96%, the market's capitalization has surged to reach N33.199 trillion as of the last trading day of the first half of 2023. As the barometer of the Nigerian economy, the capital market's positive outing reflects growing investor confidence in the country's economic prospects.

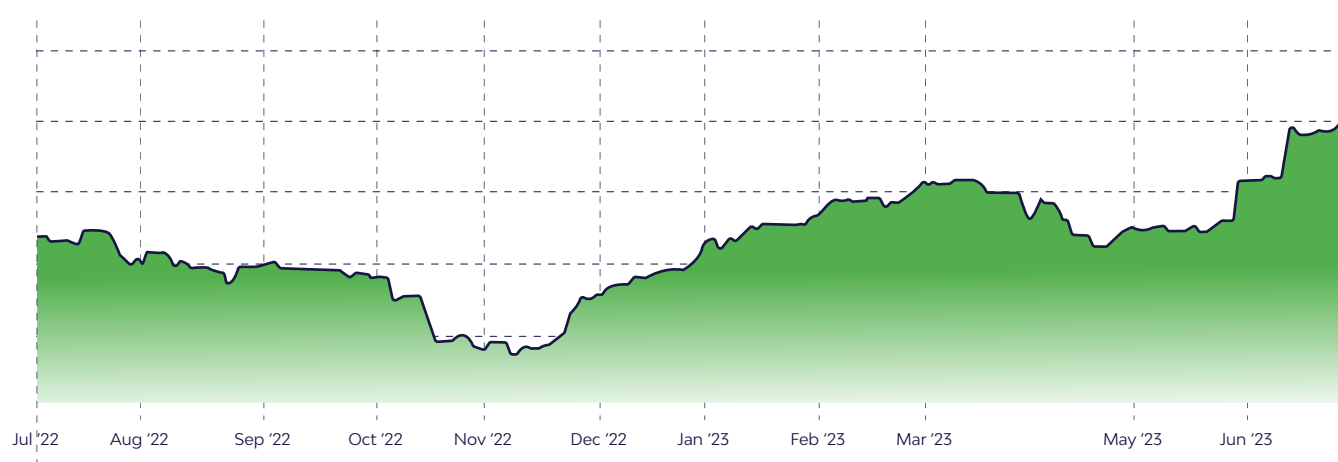


Figure 11: Performance of the Nigeria Exchange Group (NGX) All-Share Index (ASI) in the past 12 months. Source: NGX Group

What will H2 2023 look like?

The recent suspension and subsequent arrest of Mr. Godwin Emefiele, the Governor of the Central Bank of Nigeria (CBN), have been key catalysts in driving the market's positive momentum. Additionally, the changes implemented in Nigeria's foreign exchange operational framework have been well-received by market participants, leading to heightened expectations of increased foreign portfolio investment inflows.

The Nigerian financial market is expected to remain volatile in the second half of 2023. The stock market, foreign exchange rate, and banking sector are all expected to face challenges, mostly due to the volatility influenced by the recent macroeconomic reforms. The bond market is also expected to be volatile due to uncertainty about the future of the naira. The main risks to the outlook are rising oil prices, declining external reserves - the biggest decline in six years—and rising NPLs.

For the banking sector, one primary concern is the anticipated increase in the non-performing loan (NPL) ratio, which is likely to exert pressure on bank profitability (including higher interest rates). Additionally, the bond market is expected to exhibit volatility, with yields fluctuating based on investor sentiment and market conditions.

The Nigerian currency, the naira, is projected to remain under pressure, leading to continued depreciation against major currencies. This depreciation is expected to impact various sectors of the economy.

Furthermore, foreign direct investment (FDI) is anticipated to remain low, primarily due to uncertainty surrounding the future of the naira and concerns about the overall business environment in Nigeria. These factors collectively contribute to a challenging outlook for the financial market's performance in Nigeria during the second half of 2023.

Regardless of the challenging outlook; clarity, stability, decentralization of the market, and the implementation of complementary policies to attract foreign currency inflows are key to creating an environment that encourages investment, drives economic growth, and enhances the overall performance of the financial market in H2, 2023.

03

INVESTMENT CLIMATE AND BUSINESS ENVIRONMENT

Investment Climate and Business Environment

8.1 Capital Flows Analysis

The recent trends in Foreign Direct Investment (FDI) and FPI flows have been bleak and have reached historically record lows. FDI inflows have declined in recent years, as shown in Figure 12, while portfolio investment inflows have continued to decrease to record lows, according to the World Bank as of 2022.

The decline in FDI inflows can be attributed to several factors, including the global economic slowdown, Nigeria’s failure to attract foreign investments, and the poor performance of the country in terms of improving the business environment.

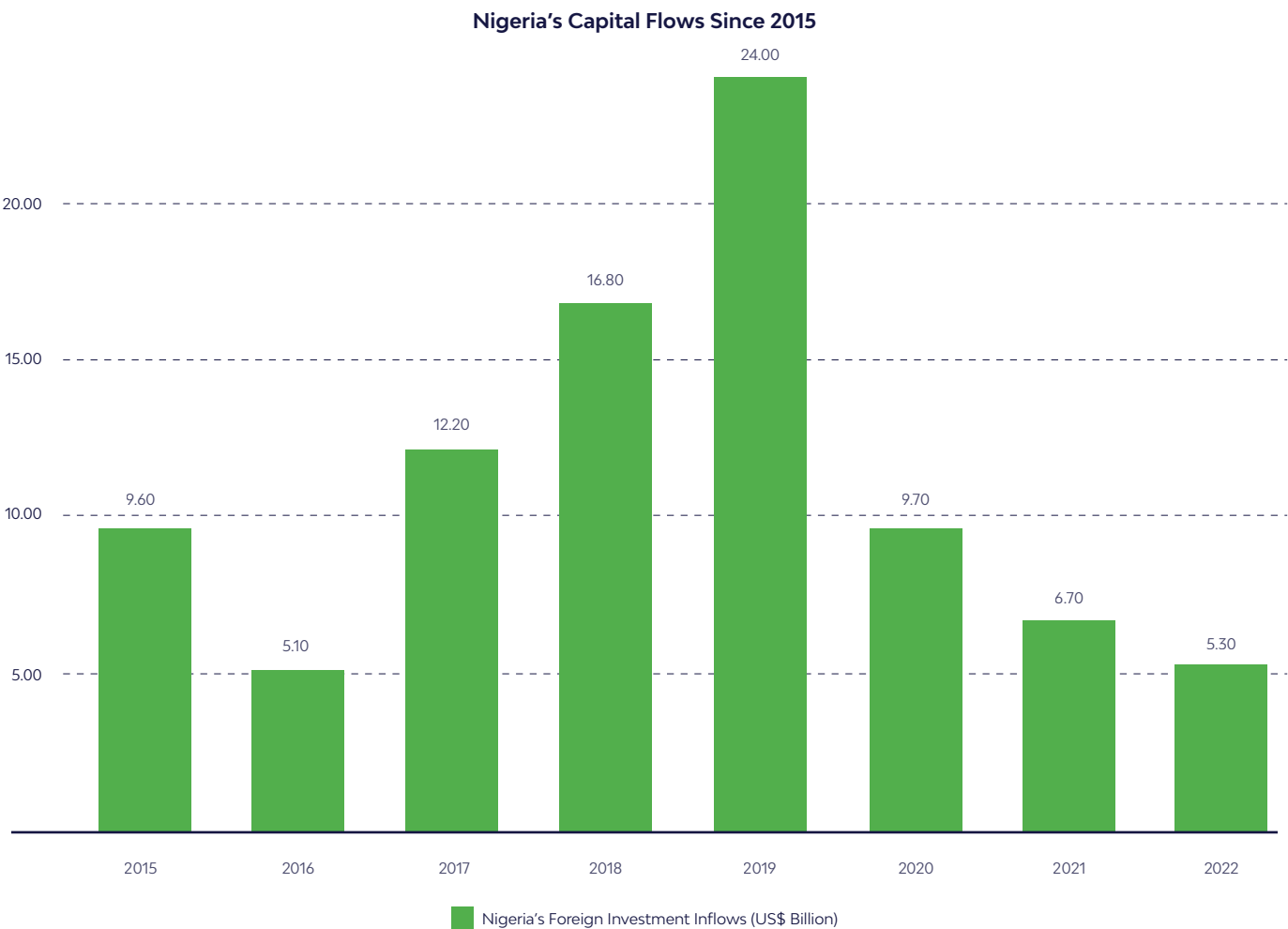


Figure 12: Nigeria’s Foreign Investment Inflows since 2015 in \$USD. Source: National Bureau of Statistics (NBS)

FDI inflows into Nigeria declined to US\$468.1 million in 2022, a 33% decrease from the previous year, as shown in Figure 12 above. This represents the third consecutive annual decline in FDI inflows.

There are a number of factors that may have contributed to the decline in FDI inflows into Nigeria. These include policy inconsistencies, stringent foreign exchange controls, infrastructure deficits, and logistical bottlenecks. Policy inconsistency has made it difficult for foreign investors to plan their investments in

Nigeria. Stringent foreign exchange controls have made it difficult for foreign investors to repatriate their profits. The infrastructure deficit has made it difficult for businesses to operate in Nigeria. Logistic bottlenecks have made it difficult for businesses to import and export goods.

FPI inflows into Nigeria fell to a six-year low of US\$2.4 billion in 2022, as shown in Figure 13 below. This represents a 29.4% decrease from the previous year when FPI inflows totaled US\$3.4 billion.

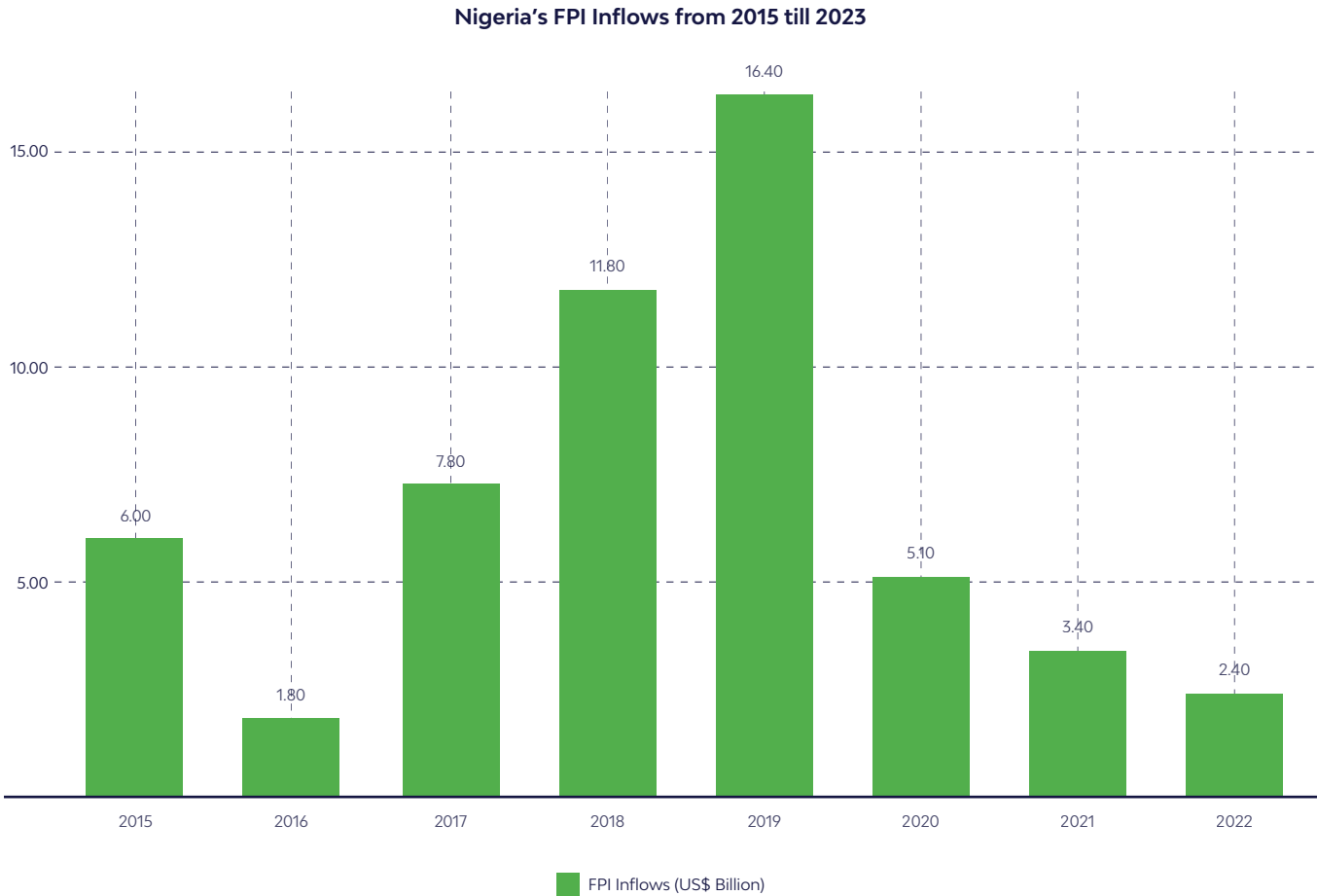


Figure 13: Nigeria's FPI inflows (US\$ Billion) since 2015. Source - National Bureau of Statistics (NBS)

A breakdown of the FPI data shows that foreign investors were particularly subdued in their uptake of equities and money market instruments. According to the Nigerian Stock Exchange, the participation of foreign investors in the equities market fell from 23% in 2021 to 16% in 2022.

In Q1 2023, Foreign Portfolio Investors scaled down their investments in Nigerian stocks by 58.3% year-on-year in the first quarter of 2023. The total value of FPI participation in the stock market fell from N128.91 billion in Q1 2022 to N53.71 billion in Q1 2023. FPI outflows outpaced inflows in the first quarter of 2023, with N35.59 billion in outflows recorded against N18.12 billion inflows.

Unsurprisingly, total foreign portfolio participation increased by 338.72% from N8.47 billion (about \$18.31 million) in April 2023 to N37.16 billion (about \$79.88 million) in May 2023. In the first quarter of 2023, Nigeria attracted the sum of \$222.3 million in portfolio investments into the equity market, per the latest capital importation report by the NBS. An increase of about 4,472% from the immediate past quarter, the 4th quarter of 2022. This significant increase in FPI participation suggests that investors are interested in Nigeria's economy due to recent policy reforms.

Despite the liberalization of foreign exchange controls by the CBN into a managed float, FPI investors want to ensure that market yields are attractive to them. Thus, they have implored for further increases in interest rates.

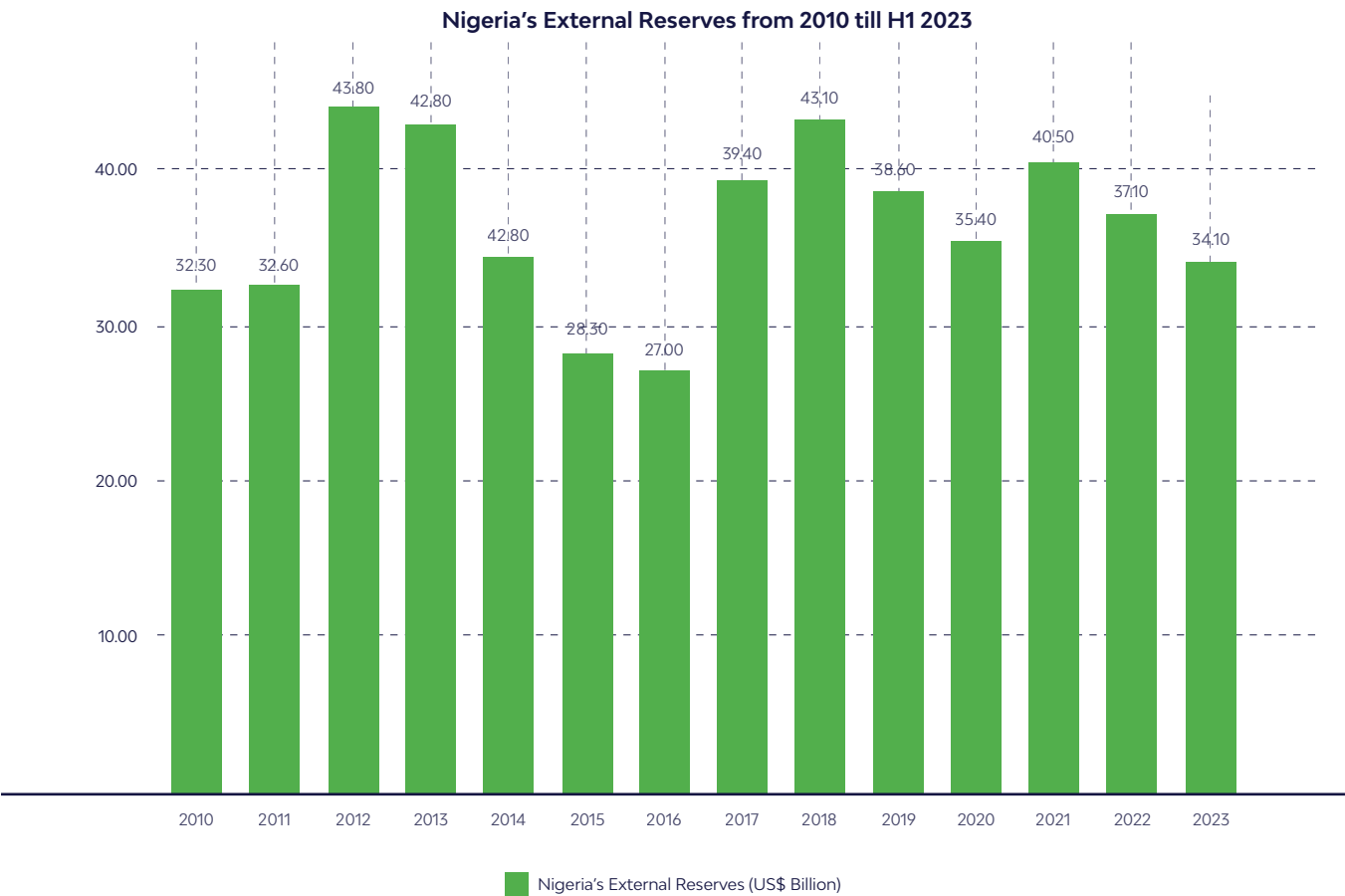


Figure 14: Nigeria's External Reserves from 2010 until the first half of 2023. Source: Central Bank of Nigeria (CBN)

Investment Climate and Business Environment

8.2 Nigeria's Business Environment

While both the Companies and Allied Matters Act (CAMA) and the Petroleum Industries Bill were passed into law in 2021 to significantly increase the ease of doing business in Nigeria, much remains to be desired in that regard in Nigeria's challenging business environment as we head into the second half of 2023.

There are core challenges that need to be addressed in order to further improve the business environment in Nigeria. These challenges include the high cost of doing business, the lack of access to credit, and inadequate infrastructure.

Nigeria was added to the Financial Action Task Force's (FATF) enhanced monitoring list on February 24, 2023, increasing investment risk and international business risk with regard to doing business in the country. However, the economic impact of Nigeria's FATF grey-listing is likely to be limited in practice. Many businesses, especially foreign corporations, have since responded to the greylisting with enhanced due diligence.

With regard to the early market reaction to the flurry of macroeconomic policy reforms carried out by the new Tinubu presidency, it has been strongly positive.

Businesses in Nigeria report significant Foreign Exchange (FX) shortages, which have to be met by a combination of delayed payments and the use of their own FX funds and purchases in the parallel market. Foreign Direct Investment (FDI) is currently low at around 1% of GDP, with weak investor appetite.

There are still huge FX backlogs for a number of foreign businesses to be cleared. For example, Ethiopian Airlines currently has about \$180 million stuck in unrepatriated funds in Nigeria due to Nigeria's serial FX shortages. This has since forced both the CBN and the National Bank of Ethiopia into a currency swap deal, exchanging \$100 million in blocked funds to address severe shortages of hard currency in both countries. This temporary swap is expected to alleviate the foreign currency challenges faced by both countries.

Bureaucratic and burdensome customs procedures also add significant costs and delays to cross-border trade. Energy access remains a challenge for businesses and households. Power outages are frequent, leading to widespread use of backup generators, again adding significant costs to business operations.

Regarding Nigeria's business environment as H2 2023 commences, there are expectations of policy reforms, including expansive implementation of reforms to simplify the business registration process across-board, improve the efficiency of the federal tax system, and strengthen the protection of property rights.

President Tinubu's recent decision to set up the Presidential Committee on Fiscal Policy and Tax Reforms to champion progressive tax law reforms is another pointer to these expectations.

What will H2 2023 look like?

The investment climate in Nigeria is expected to improve in H2 2023. The government has made tax reform and improving the business environment a priority, and it has taken steps to simplify the tax code, reduce tax rates, and improve tax compliance.

An example of this priority includes the issuing of four executive orders to suspend a 5% telecoms tax and the deferment of the commencement of the Finance Act from May 23, 2023, to September 1, 2023, among others.


These reforms could make Nigeria a more attractive destination for investment and boost economic growth.

The government has also made improving the business environment a priority. This includes streamlining the licensing process, reducing the cost of doing business, and improving access to credit. These reforms could make it easier for businesses to operate in Nigeria and attract new investment.

The most recent increase in FPI inflows in May 2023 suggests that investors are interested in Nigeria's economy. However, FDI inflows remain low. If the government can fully implement the reforms mentioned above, we expect that FDI inflows will increase.

Nigeria's foreign reserves declined in H1, 2023. This was due to a number of factors, including the rise in debt service payments, foreign exchange swap transactions, and the significant increase in imports.

Overall, the investment climate in Nigeria is expected to improve in H2 2023. However, there are still a number of challenges that need to be addressed, such as the high cost of doing business and the lack of access to credit. If the government can address these challenges, we expect Nigeria to emerge as a more attractive destination for foreign investments and experience a period of sustained economic growth in the years to come.



09

RISKS AND UNCERTAINTIES

Risks and Uncertainties

The Nigerian economy faces a plethora of challenges and uncertainties. A combination of dire economic conditions, controversial but necessary policy decisions, latent political tensions, and global uncertainties could impact Nigeria's economic outlook in the second half of the year.

9.1 Political Risks

The lead-up to the 2023 presidential elections was fraught with heightened political tensions, sectarian actions, and threats of a potential breakdown in law and order. While the elections have been completed, accusations of rigging, intimidation, and multiple electoral frauds remain. The presidential election and many subnational electoral results are being contested at various election tribunals. The result, especially of the presidential elections, creates significant uncertainty. A potential reversal and/or cancellation of all (or part) of the results could significantly impact the country's short-term outlook. This could be in the form of policy reversals/cancellations, breakdowns in law and order in select parts of the country, and more. On the other hand, a dismissal of the suit challenging the elections could help provide a semblance of confidence in the administration's early reform decisions. Nonetheless, such dismissal comes with its own risks of a potential breakdown in law and order in certain parts of the country.

9.2 Regulatory Risks

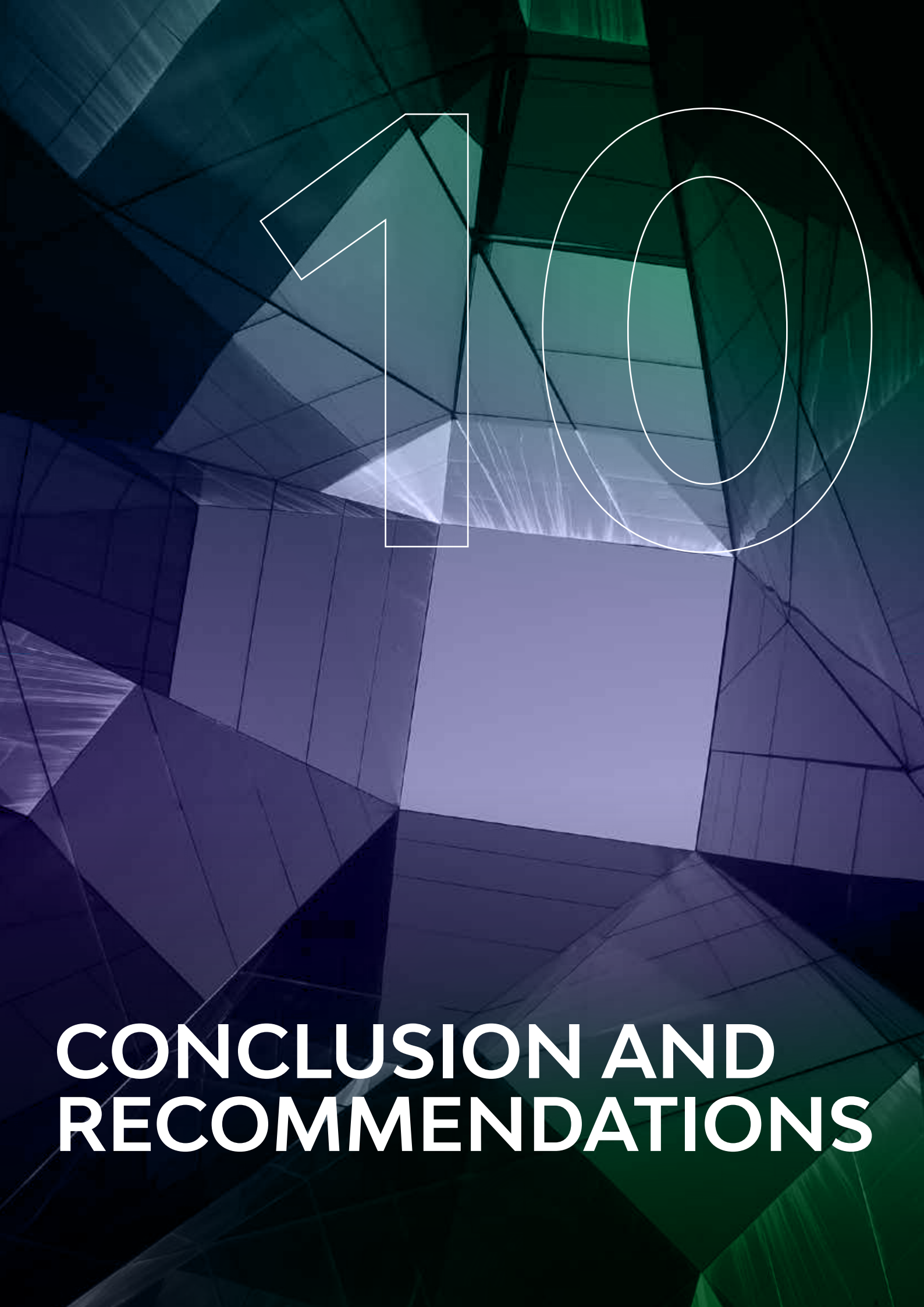
The ascension of a new reform-focused government poses multiple uncertainties in the short term. The administration has pushed through key reforms such as the removal of fuel subsidies, the unification of multiple exchange rates, and an attempt to lift some capital controls. However, the socioeconomic fallout of these policies, if improperly managed, could trigger a major pushback in the coming months as the impact worsens. This, in turn, might put the administration in a bind, potentially forcing some suspension of the aforementioned policies. Furthermore, a key risk facing the economy is excessive taxation. As the borrowing capacity of the government hollows it, its focus on increasing taxes poses fresh challenges for businesses already overburdened by existing taxes and a rapid rise in the cost of living and inputs. If unchecked, excessive taxation coupled with high costs could lead to large-scale shutdowns and/or migration of businesses to neighboring countries.

9.3 Market Risks

The country's key sectors face significant challenges. The agricultural sector faces the twin challenges of insecurity and natural disasters in key food-producing areas. The manufacturing sector faces increased costs of inputs, especially energy and key imported inputs, thanks to a devalued Naira, a proposed energy tariff hike, and increased petroleum product taxes. Finally, the service sector, including financial and telecom services, could face decreased demand as consumers cut back on non-food expenses. Thus, in the absence of a significant uptick in economic growth and investment inflows as a result of the government's reforms, the short-term prognosis for the economy remains gloomy.

9.4 Geopolitical Risks

The Nigerian economy remains susceptible to developments in other parts of the world. While reeling from the global impact of the Covid-19 pandemic, Nigeria and other developing economies have been impacted by the fallout of the ongoing war in Ukraine as well as the intractable post-COVID inflationary surge in the US and Europe. The latter challenges remain. Furthermore, China's much-anticipated economic rebound has been less than stellar. These challenges could impact demand for Nigeria's oil and other non-oil products in the coming months.

The background is an abstract composition of overlapping geometric shapes, primarily triangles and polygons, in shades of dark blue, teal, and green. A large, white, hollow outline of the number '10' is centered in the upper half of the image. The '1' is a simple vertical rectangle with a small triangular cutout at the top left. The '0' is a large, slightly irregular oval. The overall effect is modern and architectural.

10

CONCLUSION AND RECOMMENDATIONS

The outlook for the Nigerian economy in the second half of 2023 is majorly bleak. There are a number of factors that could contribute to economic growth, such as an increase in oil prices and a rebound in global trade. However, there are also a number of risks that could weigh on growth, including price shocks due to the recent macroeconomic policy reforms and a tight monetary policy stance that is currently burdening Nigeria's private sector.

Inflation is expected to remain persistent in H2 2023. This is because of its supply-side nature, which is largely exogenous to monetary policy. The implementation of the 7.5% tax on diesel will also contribute to the H2 inflation rate, as will the removal of fuel subsidies.

It is important to reiterate that the high inflationary environment is a major challenge facing the Nigerian economy. Several factors feed into the inflation rate in Nigeria, including exogenous shocks such as the Russia-Ukraine war and energy prices. Exchange rate devaluation and depreciation in the parallel market and the border closure of 2019—due to nominal rigidity—also continue to feed into inflation in Nigeria.

The CBN is likely to continue to implement a tight monetary policy stance in order to control inflation. This could further dampen economic growth. While it is necessary to prevent inflation from spiraling out of control, the CBN and the federal government must deploy non-monetary policy tools, unconventional monetary policy, and shrewd supply-side economics to address the supply-side constraints responsible for Nigeria's niggling cost-push inflation.

Furthermore, the introduction of VAT taxation for the informal sector will further burden the labor

market in Nigeria. This is because the informal sector employs a significant number of people, and the VAT tax will increase informal sector production costs. This could lead to job losses and a decrease in purchasing power, especially among Nigerians who depend on the informal economy for income generation.

The government needs to take steps to address the high unemployment rate in Nigeria. This includes investing in job creation programs, providing upskilling platforms and opportunities for workers and the unemployed, and making it easier for businesses to operate in Nigeria. This cannot be overemphasized.

The Nigerian financial market experienced a positive performance in the first half of 2023, driven by investor optimism and macroeconomic reforms. The stock market, foreign exchange rate, and banking sector all performed well, with the All-Share Index crossing the significant threshold of 60,000 index points. However, the market is expected to remain volatile in the second half of 2023, due to rising oil prices, declining external reserves, and rising NPLs.

The recent macroeconomic reforms and increased investor confidence suggest that Nigeria's financial market has the potential to perform well in the long term. The government will, however, need to continue to implement reforms and address the aforementioned challenges facing the market in order to sustain this positive momentum.

The recent removal of fuel subsidy, the devaluation of the Naira, the introduction of VAT taxation in the informal economy, and the 7.5% levy on Diesel have all contributed to rising inflation and price shocks in Nigeria. The

government can help to mitigate the negative impact of these shocks by implementing a number of policy recommendations.

One recommendation is to design and deploy both cash and non-cash palliatives to cushion the effects of subsidy removal. This could include providing cash transfers to low-income households, increasing the value of the transportation allowance for civil servants, and providing subsidized transportation means for Nigerians across the country.

Another recommendation is to effect an increase in the minimum wage, particularly for low-income earners. This would help offset the impact of rising prices on the purchasing power of low-income earners.

The government should also work with NNPC and other private sector players to increase refining capacity. This would help reduce the country's reliance on imported refined petroleum products, which would help stabilize prices in the medium to long term.

Finally, the government should implement one-off Personal Income Tax reliefs for low-income earners for up to one year. This would provide some temporary relief to low-income earners who are struggling to cope with the rising cost of living.

In addition to these specific policy recommendations, the government should also take steps to address the underlying causes of inflation, such as increasing the supply of food by making food imports easier through the temporary removal of non-tariff barriers (NTBs) on the importation of key food commodities.

By taking these steps, the government can help

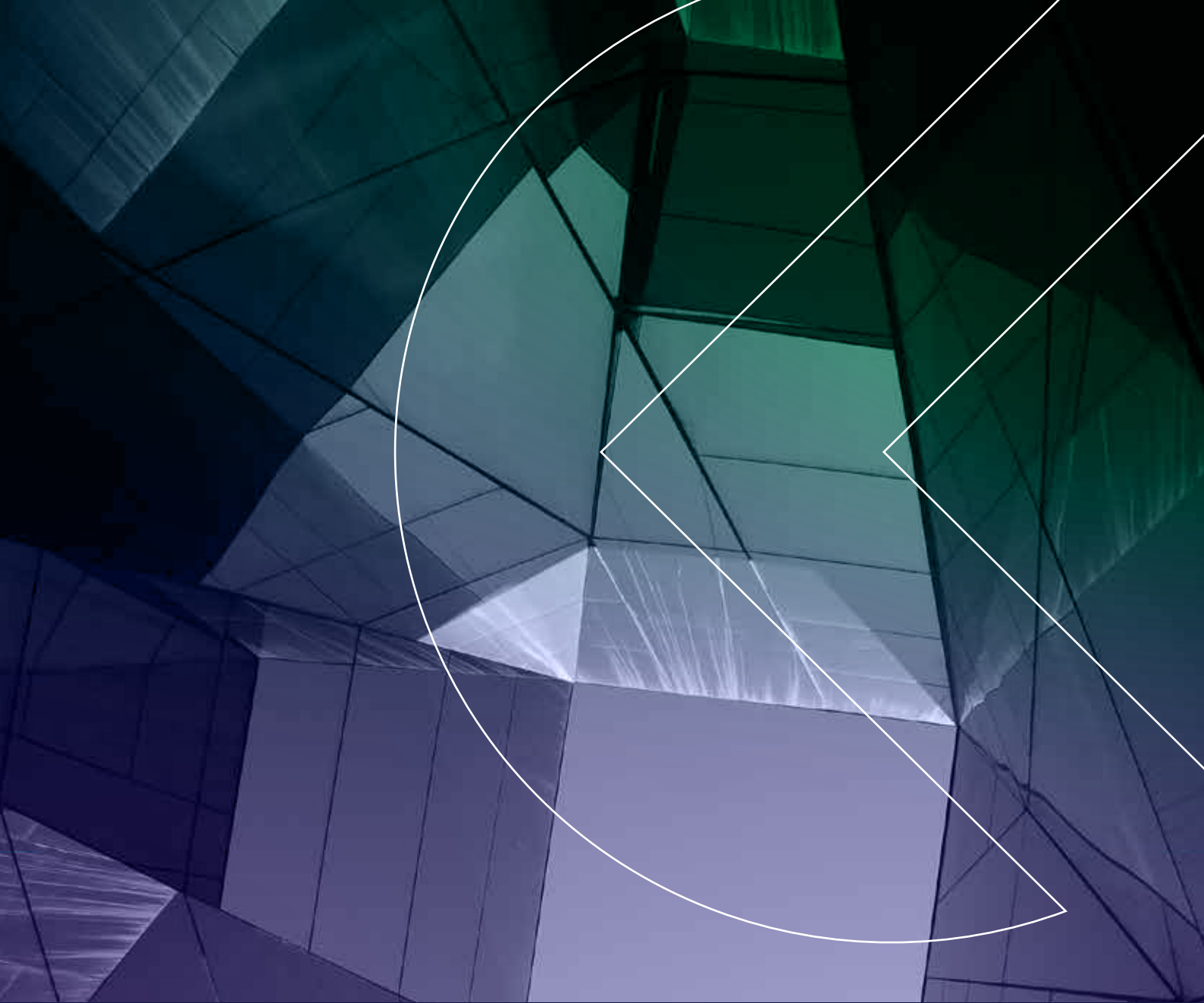
mitigate the negative impact of the recent economic shocks and protect the most vulnerable members of society.

In addition to the specific policy recommendations listed above, the government could also consider providing targeted subsidies to vulnerable groups. This could include subsidies for food, transportation, and healthcare. By providing targeted assistance to those who need it most, the government can help ensure that everyone has access to essential goods and services, even in times of economic hardship.

The federal government must keep its promise to drastically increase its investment in infrastructure. This would help to create jobs and boost economic growth, which would help the economy manage the current price shocks better and eventually stabilize.

Additionally, the federal government should strengthen the regulatory environment to protect consumers and businesses from exploitation.

By taking these steps, the government can help create a more equitable and sustainable economy that benefits all Nigerians.



 **RESEARCH**

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