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Macroeconomic update | International trade analysis | Nigeria & South Africa

Different courses, for different

IN BRIEF

- External balances are a critical determinant of capital and portfolio flows into a country.
- Fortunately, South Africa (SA) is on the sunny side of this measure as it is stacking up well in the trade stakes, compared to its other emerging market counterparts.
- Nigeria's external health, on the other hand, is prone to downside risks from costly subsidies, capital controls, and exchange rate management, as its oil industry continues to suffer from policy inconsistency and infrastructure sabotage.
- While the die of global uncertainty and financial market volatility may have been cast, SA is going into the situation in the best possible external shape, unlike Nigeria which is caught in a Penelope's web of higher crude oil prices because of its large subsidy bill.
- As a result, rand-denominated assets are likely to outperform naira-denominated assets, even though both currencies are commodity-linked.

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Against the headwinds from COVID-19 resurgences and external complexities, Africa's external sector is looking healthy, thanks to the extended rally in commodity prices. While South Africa (SA) has been sporting a trade surplus for 12 consecutive quarters (since 2Q2019), Nigeria's trade balance has been alternating between surpluses and deficits in line with global and domestic crude oil dynamics.

The global growth outturn and its impact on commodities trade will determine for how long Africa's favourable trade position persists, but South Africa's lower external risk profile – from subsidies, capital controls, and exchange rate management - puts its external sector in a more favourable position compared to Nigeria, even though both countries are reaping the harvest of the impact of the European conflict on the commodities market. As a result, we see the rand displaying more resilience than the naira in the face of tighter global financial conditions.

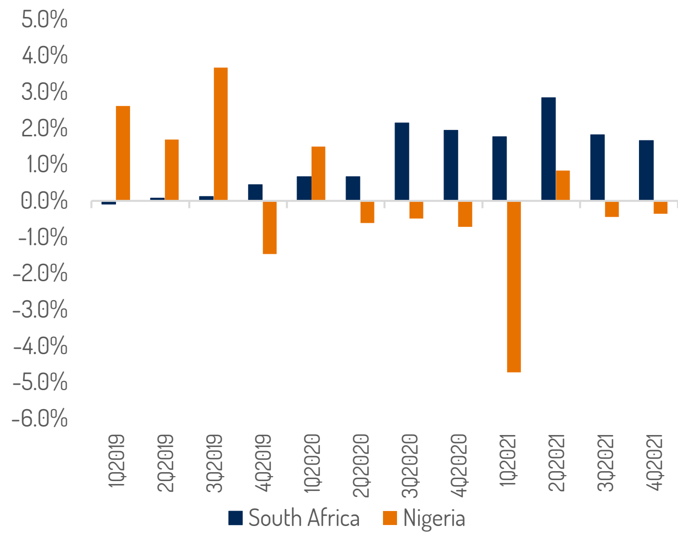
Commodities shock: A boon and a bane

The shift in global commodities dynamics (i.e. demand, supply, and value chain) could keep prices elevated for a prolonged period, leaving SA in the money and Nigeria with financial dehydration. As more countries continue to scale down their Russian dependence, new market opportunities will open up for other emerging economies and the best positioned will be countries with the least restrictive business and trade policies.

Fortune is currently smiling on SA's extractive industry, and it is enjoying a terms of trade boon from commodities – that contribute more than 70% to its total exports. As the West continues to cut back on its Russian commodities dependence, new markets are being created for some of SA's key exports - giving it a pricing advantage. The windfall from food and metals has been more than sufficient to offset the impact of higher oil prices on SA's import basket, cementing its stellar trade performance – 1.7% of GDP in 4Q2021. While SA's roaring trade on extractives has bolstered its external profile, Nigeria is a horse of a different colour.

With crude oil constituting around 79% of total exports in 1Q2022, Nigeria is predominantly a crude oil exporter. The country's exports received a significant boost in March following the European conflict that prompted a 7% m/m increase in the price of Brent. As a result, Nigeria recorded a trade surplus of NGN 1.2tn – a record balance since the onset of the pandemic. However, the shortage of oil refineries and the persistence of inefficient fuel subsidies continue to create both external and fiscal imbalances.

Trade-to-GDP (%)



Sources: Nigeria's National Bureau of Statistics, South Africa Revenue Service, South Africa Reserve Bank

SA: Foreign flows to prime the trade surplus pump

Foreign flows into SA are poised to complement the prevailing trade surplus, strengthening the country's external profile. Economic, socio-economic, and geopolitical crises raining on the parade of some top foreign flows' destinations (i.e. Turkey, Brazil, and Russia) in the emerging market universe will prompt a re-direction of emerging market-bound flows to SA.

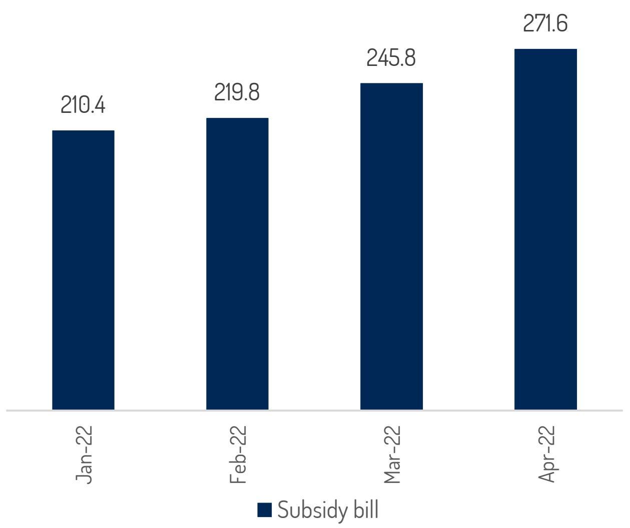
In addition to the external factors, SA's seeming "haven" status will also be supported by recent positive developments in the domestic economy – such as favourable GDP rebasing, revenues surprising to the upside, and a better debt burden outlook – that have earned it an improved view of its economic outlook by credit rating agencies. We believe these upbeat fundamentals will work in SA's favour when investors turn their backs on emerging markets during the inevitable bouts of risk-off sentiment that lie ahead.

Nigeria: Old habits to bite hard

Crude oil trading at record prices will strengthen Nigeria's external buffers, but oil consumption subsidies and infrastructure sabotage will remain a drag. Unlike SA, oil consumption subsidies will continue to drain Nigeria's trade surplus - plaguing its external profile, while oil production shortfalls due to vandalism will limit the country's capacity to earn foreign currency.

As of April, the Nigeria National Petroleum Commission's (NNPC) cost recovery shortfall (i.e. subsidy) on premium motor spirit (PMS) stood at NGN 947.5bn (USD 2.3bn) YTD, while the country's crude oil production has stagnated at 1.2mbpd despite higher production quotas from the Organisation of Petroleum Exporting Countries (OPEC). These dynamics make Nigeria unable to make the most of the ongoing rally in the global energy complex even though its trade – compared to SA - outperformed at 2.6% of GDP in 1Q2022.

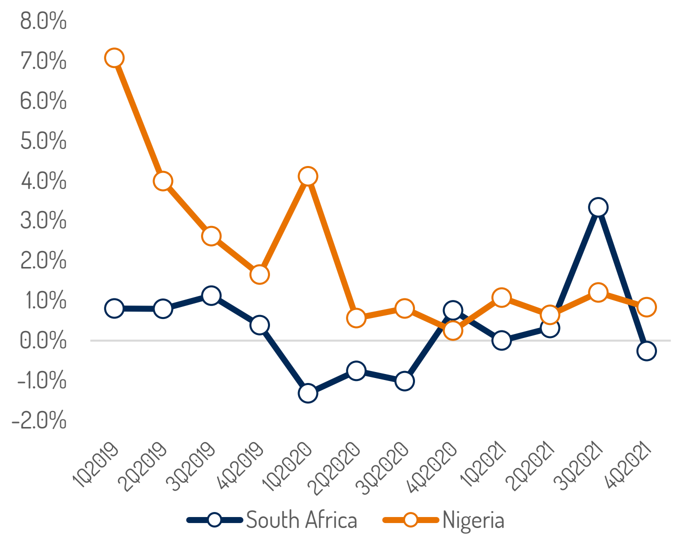
Nigeria's monthly subsidy bill (NGN'bn)



Sources: Nigeria National Petroleum Commission

However, a cocktail of import restrictions, capital controls, higher oil receipts, and a decent level of portfolio flows will help the current account to withstand these intramural pressures, keeping it in surplus. With most emerging markets getting hammered by almost the same headwinds, Nigeria could garner some financial clout by attracting portfolio flows using the interest rate to its advantage. This, alongside higher oil receipts, will ensure dollar inflow to the external coffers while import and capital repatriation restrictions will keep a rein on outflows. Therefore, in our opinion, higher oil prices will overcompensate for the genuine demand-side pressures that may hit the current account over the next 12 months.

Foreign investment-to-GDP (%)



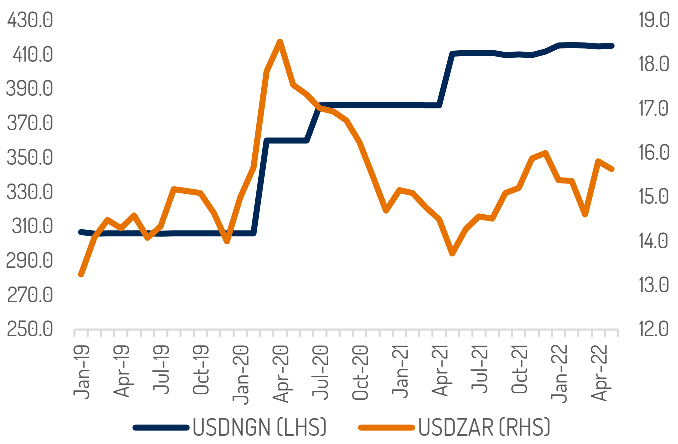
Source: South Africa Reserve Bank, Nigeria's National Bureau of Statistics

Not all roads lead to Rome

Although both SA and Nigeria are poised to record favourable current account balances, their currencies will be charting disparate paths. SA's terms of trade boon and brighter economic outlook will mitigate the impacts of quantitative tightening on the rand, compared to other emerging market currencies. Increases in the price of gold – amid the impending bouts of risk-off sentiment - will continue to rub off on SA's local currency, as the commodity is one of the country's key exports. Similarly, SA's rand will also enjoy tailwinds that come with a more favourable outlook review from credit rating agencies.

On the flip side, Nigeria's beleaguered local currency will continue to pay the price for fiscal and exchange rate misalignments that both constitute a drain on the country's external resources. PMS subsidy payments and monthly interventions by the Central Bank of Nigeria (CBN) in the foreign exchange market - to the tune of around USD 2.3bn per month – will continue to deplete foreign currency receipts realised from oil sales and portfolio inflows. Also, the continued segmentation of the foreign exchange market will intensify pressure on the unofficial window as electioneering kicks in, spurring bogus demand for the greenback.

Evolution of exchange rates to the dollar



Source: Bloomberg

Conclusion

As global trade disruptions continue to fan higher commodity prices, global uncertainty and financial market volatility are no-brainers. Global monetary policy normalisation will put emerging market economies through the wringer as the window of cheap money is closing. However, the commodities revenue windfall will provide some degree of buffer against interest rate thunderbolts.

On the face of it, harsher times lie ahead for emerging market economies, but SA is taking on the interest rate frenzy in the best possible external shape, unlike Nigeria which is caught in a Penelope's web of higher crude oil prices. Even though the impending volatility is unlikely to drive both the rand and naira into a tailspin – because they are commodity-linked-, rand-denominated assets are likely to outperform naira-denominated assets.

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