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Fundamentals

Macroeconomic update I West Africa

Inflation takes bigger bites

IN BRIEF

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- As the inflation marathon continues, everyone is obsessed with it, and why would they not be?

- Following a rollercoaster week of inflation prints, whispers of a longer period of inflation leading to a possible extended recession are picking up in terms of volume and velocity, as inflation is either at double digits - or near double digits - in most countries.

- For West Africa's (WA's) largest economies – Nigeria and Ghana –, inflation accelerated to new highs in August, leaving their monetary policy further unmoored.

- With a hotter-than-expected United States (US) inflation print in August, the odds of a jumbo 75 basis points (bps) hike by the US Federal Reserve Bank (Fed) at this week's meeting have been cemented, with more expected in the months to come.

- The unfortunate reality is that the US Fed's interest rate hike cycle will have asymmetrical spillover effects on WA's economies, creating sticky and broad-based upward pressure on domestic consumer prices in months to come.

- The end result will be more market volatility to deal with: from Nigeria's "Broad" street to Ghana's "High" street.

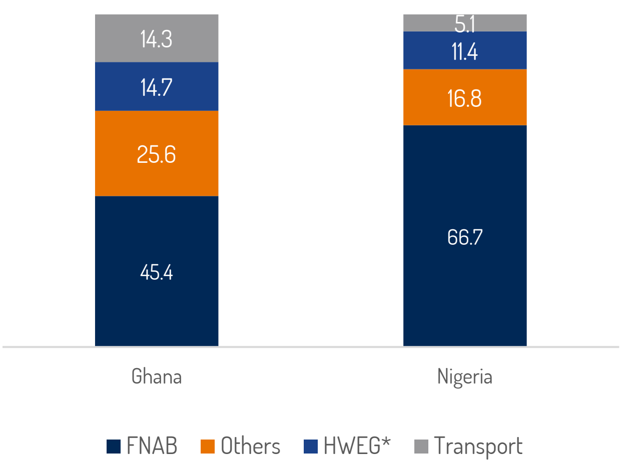
With the grim spectre of inflation returning over the last year to unleash crippling cost-of-living crises across much of the world, central banks have proven largely powerless to rein in runaway prices thus far. Despite an 850 basis points (bps) hike in the Bank of Ghana's (BoG's) policy rate in the current tightening cycle that started in November 2021, inflation continues to creep higher - reaching 33.9% y/y in August from 31.7% y/y in July. Although less botched in comparison to Ghana, Nigeria is also sailing through rough waters as headline inflation reached 20.5% y/y in August from 19.6% y/y in July.

Elevated food and energy prices continue to fuel higher inflation outcomes in many countries – including Nigeria and Ghana – and these global factors are likely to continue fueling inflation in the coming months. This could prompt both global and local central banks to lift interest rates further, a potential trigger for market volatility in the near term.

Inflation is hot...and may stay hot

Consumer prices are currently high and could go higher – riding on the price of crude oil. Due to their high relative importance in WA's consumer basket (Ghana: 43.1%; and Nigeria: 51.8%), the price spikes in food and non-alcoholic beverages (FNAB) remain the main drivers of inflation in West Africa (WA) - with an outsized contribution of 45.4% to Ghana and 67.4% to Nigeria's inflation uptick in August. Food prices in Ghana and Nigeria quickened for the umpteenth time in August to 34.4% y/y and 23.0% y/y respectively, and continue to be driven by higher input costs across fuel, chemicals, and fertiliser.

Contribution to annual inflation in August (%)



Sources: Ghana Statistical Services, National Bureau of Statistics

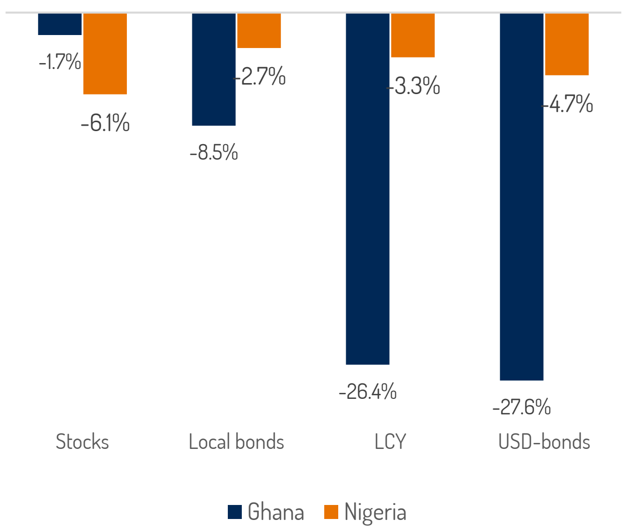
HWEG* - Housing, water, electricity, gas and other fuels

The World Economic Forum estimates that the price of crude oil influences as much as 64% of food price movements, while sanctions on Russia could increase the cost of fertilisers by about 70%, partly due to Russia's dominance of the global fertilizer market. Therefore, as long as the war protracts, the associated supply disruptions will continue impacting food and energy prices in Africa, and spur domestic inflation. However, easing global supply-chain bottlenecks and an impending global recession can take some steam out of the subregion's overheating economies.

Bulls are nowhere to be seen

WA's financial markets are already buckling to the inevitability of rate rises under hot consumer price index (CPI) readings - both globally and locally -, and this trend is likely to persist in the coming months. Inflation episodes in WA may be prolonged by further financial market volatility in the sub-region, as investors panic and sell their financial assets. Inflationary forces chugging along edges WA's economies closer to stagflationary scenarios in the base case, or a recession in the worst-case scenarios. These would shrink household incomes, and business profitability with an adverse impact on revenue mobilisation by the sub-regional governments, deepening investors anxiety and portfolio de-risking across the subregion's financial markets.

3-month financial market performance (as of 15th September)



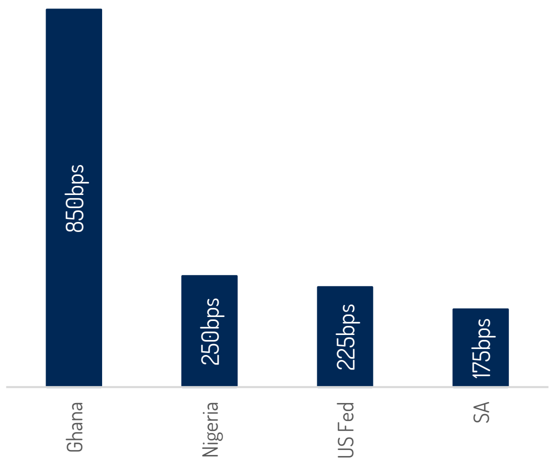
Sources: Bloomberg, S&P Global

Likewise, inflation in the United States (US) surprising to the upside in August may have derailed any short-term bullish momentum for the wider risk assets spectrum that may have been building over the past month – when the brief cooling in US inflation in July fueled expectations of a less aggressive US Fed. The prospects of hotter-than-expected inflation prints in the US in months to come exposes emerging markets to spillovers from tightening monetary policy in advanced economies, which is negative for emerging market currencies.

The price to pay

As another round of central bank monetary policy meetings commences this week, policy decisions from Africa could include more rate hikes. Some central banks may tighten monetary policy further to keep inflation under control and to forestall local currency depreciation – particularly as interest rates in the US rise, drawing capital away from riskier African economies. Ghana is already leading the pack in WA with its 850bps cumulative increase in its monetary policy rate.

Degree of monetary tightening since November 2021



Source: Bloomberg

Unfortunately, monetary tightening may not suffice to cool price pressures in the near term. Across Africa, like in other regions, central banks are constrained to increase interest rates in desperate attempts to rein in rising prices. However, rate hikes can, really, only impact the demand side of inflation – which if taken too far can plunge the economy into a recession.

Rate hikes are not effective for supply shocks such as snarled supply chains, the war in Ukraine, or even Russia's recent gas supply halt to Europe. However, we believe that Africa's central bankers will continue the current policy course, and a soft landing will be a stretch as elevated commodity prices, elevated shipping costs, and weaker local currencies pass through to push inflation higher in the months to come.

Conclusion

While we still anticipate global supply-demand imbalances to wane, inflation is likely to be higher for longer than previously thought. This suggests that real rates could plunge even lower in countries like Nigeria and Ghana where inflation targets are unmoored. Also, the hotter-than-expected inflation print from the US in August pushes back any US Fed pivot that the markets were hoping for in the near term and sets the stage for more financial pressure via rate hikes.

As the second-round effects of the recent oil price shocks continue to kick in, the cost-of-living crisis has become a major headache for Africa's policymakers, and the trifecta of lower growth, higher inflation, and higher interest rates could hit even harder as monetary policy continues to walk a fine line between tackling inflation and financial risks.

HWEG* - Housing, water, electricity, gas and other fuels

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