Macroeconomic Update | Inflation Report

Quarterly Guidance | Q2:2022

Global Inflation:

Rising Inflation and Geopolitical Tension Wanes Economic Outlook

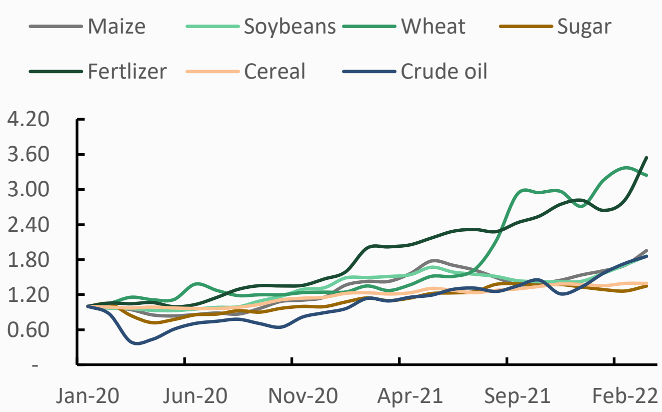
At the start of 2022, expectations surrounding global growth prospects were largely optimistic, as major economies rebounded strongly from the pandemic's impact in 2020. This rebound was supported by the rollout of several monetary and fiscal stimulus which contributed to higher liquidity in the system and exacerbated inflationary concerns.

While the global economy is yet to fully combat the impact of COVID-19, the emergence of geopolitical tension between Russia and Ukraine has placed further concerns on global economic outlook, intensifying the already severe inflationary pressures. Following the invasion, many economies (particularly the United States, Europe, Canada, and other advanced countries) have imposed dire economic sanctions on Russia, exposing global supply chain activities to further risk.

As the geopolitical tensions between the two countries persist, rising food, energy, and commodity prices have continued to plague the global economy. This is mainly due to Russia and Ukraine's significant role in global supply of some commodities; major economies (particularly Europe) rely on both countries for the importation of commodities such as crude oil, gas, wheat, and palladium, among others.

Russia is responsible for the production of c.13.00% of the global crude oil, c.17.00% of natural gas, amongst other commodities while both countries jointly account for c.29% of global wheat production. At the tail end of Q1:2022, crude oil prices peaked at USD127.98pb (from USD77.78pb as of Dec 2021) due to its limited supply, while wheat prices have climbed +19.53%YtD. Until a truce is reached between both countries, it is expected that the tension will continue to fuel higher global inflation.

Chart 1: Selected Commodities Prices



Source: World bank, USDA, FAO, Bloomberg, Meristem Research

Recent inflation data show that prices are peaking at the fastest pace in decades, with Europe being one of the largest hit as it relies on Russia for c.25% of its crude oil and c.40% of its natural gas.

Europe recorded a 7.40% increase in CPI for March (vs. 5.90% in February). Also, inflation rates rose significantly in the United States, Russia, and the UK (from 7.90%, 9.15% and 6.20% in February to 8.50%, 16.70% and 7.00% in March, respectively).

The narrative in China was different, as the reality did not mirror that of other emerging economies. The country recorded slower growth in its headline inflation in January due to the lower food prices and weakening demand. However, the country's inflation figure for March rose to 1.50% from 0.90% in February, influenced by the recent spike in the number of COVID-19 cases, which has led to the implementation of strict lockdown measures in major cities.

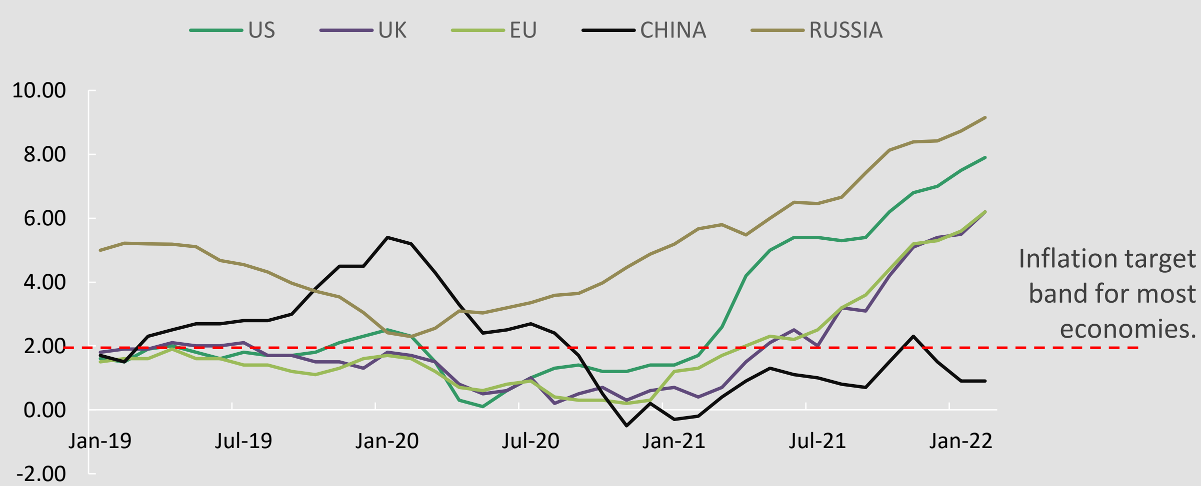
Monetary Authorities' Response

The elevated supply-driven inflationary environment makes a case for the current tightening of the key policy rates. As such, several monetary authorities have began hiking their key policy rates to control the impact of the rising prices on the global economy.

The US Fed has adopted a hawkish stance by hiking its key interest rate to 0.75% - 1.00% in May and is expected to increase the rate further during the year. The Bank of England also hiked its key interest rate for the third consecutive time to 0.75% (from 0.50% in March 2022). In addition, the Central Bank of Russia hiked its key interest rate twice in February (by 100bps to 10% and 20) to control capital flight and price increase. However, the Central Bank of Russia has decided to cut its interest rate twice in April to 17% and 14% to mitigate the impact of the several external sanctions on its economy.

The European Central Bank (ECB) opted to maintain the key interest rate, focusing on economic growth rather than inflationary concerns. The ECB, however, intends to raise its key interest rates later this year after ending its asset purchase program. The People's Bank of China (PBOC) also maintained its key interest rate (2.85%) at the current level.

Chart 2: Inflation Rate of selected Countries.



Source: Bloomberg, Meristem Research

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Sub-Saharan Africa:

Risks Tilted to the Upside

Movement in price levels in major sub-Saharan African (SSA) countries have largely mirrored the trend in the global environment. Being import dependent countries, the area's major import items include crude oil and minerals, wheat, motor vehicles, soybeans, cereals, oil seeds, fertilizers, sugar etc. Prices of these commodities have therefore surged in the sub-Saharan market due to the supply gap created by the Russian and Ukraine crisis .

For context, PMI survey data for Ghana showed that the sharp rise in input prices – *due to rising fuel cost (+41.68% YtD) and currency weakness (-28.40% YtD)* – influenced the spike in output prices for the period. The Egyptian pound was also devalued in March by c.17% as foreign investors withdrew their investments in the country for safer havens, exerting further pressure on the currency. Higher freight costs caused by the pandemic have also heightened the inflationary pressures for countries in the regions.

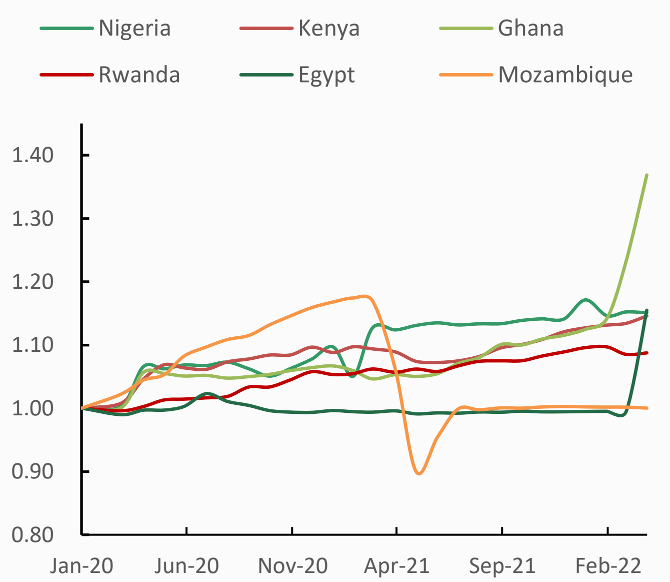
Notably, Inflation rate in Ghana ticked up to 19.40% in March – the highest since November 2016 – (up from 15.70% in February). Egypt, South Africa and Rwanda also witnessed similar upticks at 10.35%, 5.90% and 5.60% (vs. 8.80%, 5.70% and 4.20% in February), respectively.

On the contrary, the sentiments in Mozambique and Angola reflected a disinflation as the inflation rate declined to 6.67% and 28.5% in March (vs 6.84% and 29.7% in February).

In response, some of the monetary authorities across the region have hiked their interest rates so as to curb the spiraling inflation and align with global interest rate hikes. The Bank of Ghana also banned the use of foreign currency for transactions on the domestic front, in order to reduce the FX pressure on its currency. Looking forward, we expect the weaker currency issues as well as supply side factors to keep prices elevated. The inability of countries in the region to achieve self-sufficiency on specific commodities should also translate to further pressure on prices due to volatility of global prices and domestic exchange rates. Thus, we also view the uptrend in global inflation as a major upside risk for SSA economies. However, the shift to a more hawkish policy stance should potentially moderate the impact.

Also, in order to curb the impact of recent rake hike on the economy, we do not foresee additional rate hikes during the year. Central banks would also consider the potential negative impact of additional rate hikes on economic growth.

Chart 3: Currency Movement for Selected Countries.



Source: Bloomberg, Meristem Research

Inflation Rate of Select Countries

Global Market

Country	Inflation Target band	March Inflation	Monetary Policy action in 2022
Russia	4.00%	16.70%	Reduced rates to 14% in April *from 17%*
United States	2.00%	8.50%	Hiked rates to 0.75 to 1.00% (vs. 0.25-0.50%)
European Union	2.00%	7.40%	Held rates constant at 0.00%-0.50%
United Kingdom	2.00%	7.00%	Hiked rates to 1.00% (vs 0.75%)
China	3.00%	1.50%	Held rates at 2.85%

Sub-Saharan Africa

Country	Inflation Target band	March Inflation	Monetary Policy action in 2022
Ghana	6.00% -10.00%	19.40%	Rate hike to 17% (from 14.50%)
Nigeria	6.00% -9.00%	15.92%	Held rates constant at 11.50%
Egypt	5.00% - 9.00%	10.85%	Rate hike to 9.75% (vs 8.75%)
Mozambique	5.00%-7.00%	6.67%	Rate hike to 15.25% (from 13.25%)
Kenya	2.50% -7.50%	5.60%	Held rates at 7.00%
South Africa	3.00% - 6.00%	5.90%	Rate hike to 4.75% (from. 3.75%)
Rwanda	2.00% - 8.00%	5.60%	Rate hike to 5.00% (vs. 4.50%)

Nigeria:

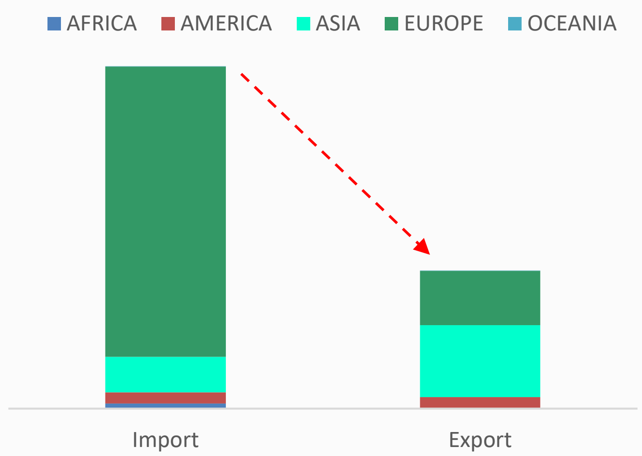
No Moderation in Sight

Although Nigeria's headline inflation showed a moderation at the start of the year (15.60% in January from 15.63%), it has begun to trend upwards. Major triggers remain cost pressures resulting from mostly external factors such as rising global commodity prices, record high inflation posted by key trading partners and falling currency value. Nigeria is exposed to these risk factors due to the country's high dependency on import, with severe impacts on both the country's core and food inflation indexes.

Items which have consistently been tagged as major drivers of the core index include liquid fuel, gas prices, spare parts of cars, and personal wears, which are mostly imported items. Year-to-date, prices of deregulated liquid fuel like diesel, kerosene, and jet fuel have more than doubled. We also believe this in addition to the lingering insecurity challenges

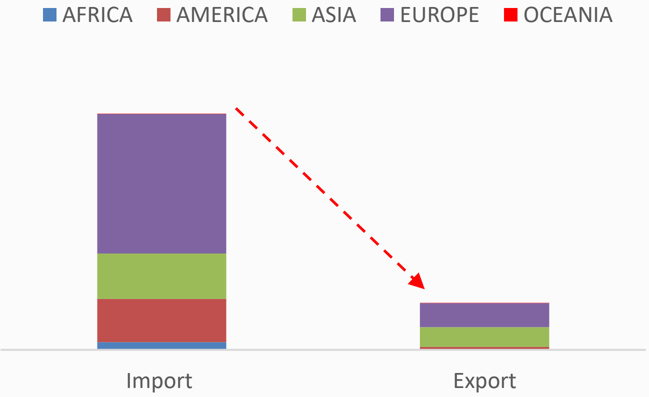
The effects of imports far exceeding exports (especially for major imported products like liquid fuel and agricultural produce) are two-folds: weakening of the Naira, and vulnerability of the country to rising inflation experienced by trading partners.

Chart 4: Nigeria's Trade Balance for Oil Products excluding crude oil (Q4:2021)



Source: National Bureau of Statistics, Meristem Research

Chart 5: Nigeria's Trade Balance for Agricultural goods (Q4:2021)



Source: National Bureau of Statistics, Meristem Research

in most food producing states have impacted logistic cost, thus raising the prices of some food items. In March, the food index rose by 19.20%, 9 basis point higher than the previous month, in contrast to the disinflation seen since January. The impact of post harvest supplies in cushioning the rate of price movement has begun to wane as global uptick in commodity prices has proven to be a more severe upside risk.

Similarly, prices in both the urban and rural region are increasing considerably on a month-on-month basis. States like Kogi and Cross River led the chart in at least two out of the three months in Q1:2022, experiencing the highest headline inflation rate of 18.18% and 18.42% respectively in March. At the bottom of the chart is Kwara state, consistently recording the lowest inflation rate year-on-year of not more than 15% monthly. We attribute this to high base seen last year as the state recorded one of the highest index jump during the period.

Outlook:

Still Plagued by External Factors

Our model suggests headline inflation would continue its uptrend up until June when rate is predicted to begin to moderate. Hence, for April, May and June, we expect consumer price index to grow by 16.04%, 16.10%, and 16.08% respectively. This is on the back of slower growth of the core index which recently recorded a disinflation in March. Therefore, going into the quarter, our calculation suggest an average of 16.07% for Q2:2022, however still lower than Q2:2021 which pitched at 17.93%.

The following are the risk factors considered.

Upside Risk:

1. Russia-Ukraine war lingers, disrupting supply chain and keeping commodity prices elevated.
2. The recent ban Indonesia placed on its crude palm oil exports should result in heightened CPO prices globally. This will also impact local market as the 30% import levy and the FX restriction placed on CPO will further enable producers to increase prices in the domestic space.
3. Rising cost of liquid fuel impacting producer prices and logistics cost.
4. Insecurity issues exacerbating in major food producing regions, thereby limiting supply.
5. Except for maize, no post-harvest supply is expected in the quarter.
6. Inflation continues to rise for trading partners.

Downside Risk:

1. Possible change in the stance of the monetary authorities in favour of a rate hike.

Contact Information

Investment Research
research@meristemng.com

Analyst Coverage

Praise Ihansekhien
praiseihansekhien@meristemng.com

Kelechi Chidi-Ihuoma
kelechichidi@meristemng.com

Juliana Ogunkoya
julianaogunkoya@meristemng.com

Corporate websites: www.meristemng.comwww.meristemwealth.comwww.meristemregistrars.com

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