MERISTEM

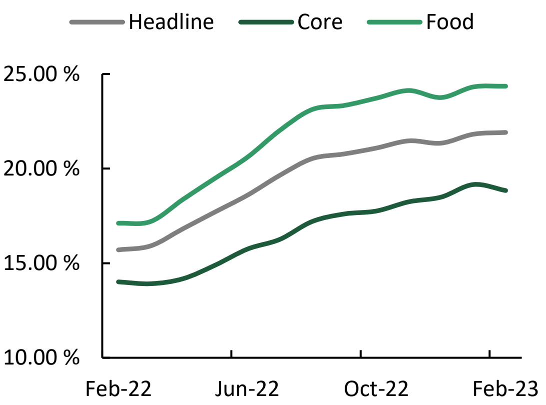
Macroeconomic Update

Inflation Report | February 2023

Key Summary Statistic

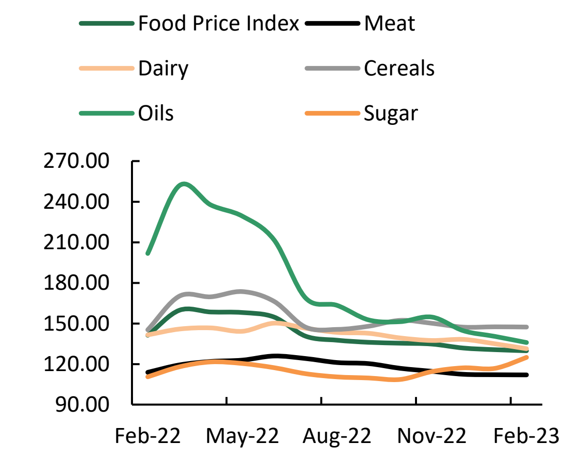
Category	Feb-2023	Jan-2023	Feb-2022
Headline inflation	**21.91%**	21.82%	15.70%
Food inflation	**24.35%**	24.32%	17.11%
Core inflation	**18.84%**	19.16%	14.01%
Imported Food inflation	**19.00%**	18.89%	17.62%

Chart 1: Trend in Headline, Food and Core Inflation



Source: NBS, Meristem Research

Chart 2: Global Food Prices (Feb 2022 – Feb 2023)



Source: FAO, Meristem Research

The National Bureau of Statistics (NBS) reported an increase in headline inflation for February 2023 to 21.91% YoY (vs. 21.82% YoY in January 2023), 3bps above our projection of 21.88% YoY. The uptick in headline inflation was mainly driven by the food index which edged higher by 24.35% YoY (vs. 24.32% YoY in January 2023). Price increments on food items like bread, cereals, oil and fat, potatoes, yam and other tubers, fish, fruits, meat, and vegetables spurred the increase in the food inflation rate. Conversely, movement in the core index moderated for the first time since April 2022 to 18.84% YoY (vs. 19.16% YoY in January 2023) mainly driven by increases in the prices of gas, air transportation fare, liquid and solid fuels, vehicle spare parts, among others. On a monthly basis, both the food and core inflation slowed down to 1.90% MoM and 1.06% MoM (vs. 2.08% MoM and 1.82% MoM in January 2023), respectively. We expect the sustained uptrend in headline inflation as well as the current cash crunch and its effect on the economy to be a key consideration for the Monetary Policy Committee at its upcoming meeting. Hence, we anticipate a (at least) 50bps hike in the Monetary Policy Rate (MPR).

Stock Piling and FX Volatility Triggers Higher Prices

Across various regions, preparations ahead of the recently concluded Presidential election included stockpiling of foodstuff and household consumables, thereby leading to higher prices. Thus, food inflation grew in February. Imported food inflation also increased to 19.00% YoY (vs. 18.89% YoY in January 2023) despite the moderation in global food prices for the 11th consecutive month by 8.10% YoY (vs. a moderation of 3.70% YoY in January 2023), as reported by the Food and Agriculture Organization (FAO) food price index. We therefore infer that the challenges with persistent FX illiquidity are a major catalyst in the northward movement of the index. The lingering perennial challenges plaguing the agricultural value chain (poor infrastructure, low productivity, among others) is also a major factor keeping food prices on the upside.

The Month-on-Month food inflation rate however declined in the month, which cannot be delinked from the impact of the cash crunch. Given that 41.43% of transactions in the informal sector are settled in cash (according NBS's 2015 GDP report), we infer that the cash scarcity created a gap in demand, leading prices slightly lower. In the near term, we expect a moderation in food inflation on a yearly basis hinged on the high base effect as well as slower demand for food items resulting from the cash crunch in the economy.

First Core Disinflation in 11 Months

The core index grew at a slower pace mainly driven by the high base effect from February 2022. In addition, given that an average of 55% of domestic gas is imported, we posit that the pass-through effect of the moderation in international gas prices (-38.76% YoY as of February 2023, as reported by the World Bank Commodity Price Index) impacted domestic gas prices partly driving the disinflation. Moreover, on a monthly basis, the exchange rate remained relatively stable on the I&E window (average of NGN461.54/USD in February 2023 vs. NGN461.55/USD in January 2023, while parallel market rates also declined by 1.47%). We however identify the likelihood of the fuel subsidy removal by the incoming administration to pose an upside risk to core inflation in the medium term.

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