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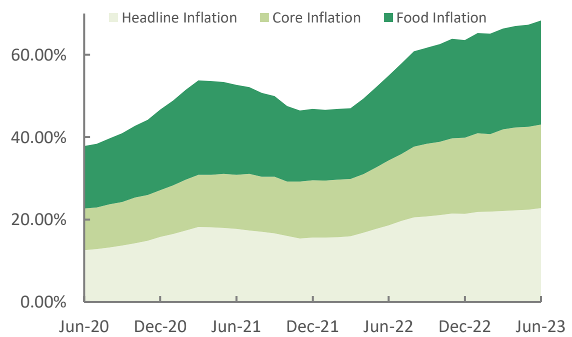
Macroeconomic Update

Inflation Report for June 2023

Key Summary Statistics

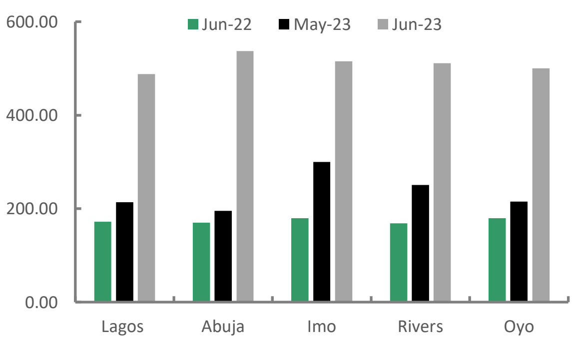
Category	Jun-2023	May-2023	June-2022
Headline inflation	22.79%	22.41%	18.60%
Food inflation	25.25%	24.82%	20.60%
Core inflation	20.27%	20.06%	15.75%
Imported Food inflation	19.10%	18.72%	17.84%

Chart 1: Trend in Headline, Food, and Core Inflation



Source: NBS, Meristem Research

Chart 2: Trend in PMS Prices in Selected States



Source: NBS, FMDQ, Meristem Research

The National Bureau of Statistics reported headline inflation in June 2023 as 22.79% YoY (vs 22.41% YoY in May 2023). While we anticipated an uptrend, the headline inflation comes in 104bps lower than our forecast of 23.83%. This upward trend in inflation can be attributed to an unabating increase in both food and core indices. The food index spiked by 25.25% YoY (vs 24.82% YoY in May 2023), owing to rising prices of food items such as oil and fat, bread and cereals, fish, yam, and other tubers, meat, vegetable, milk, cheese, and eggs. Similarly, core inflation stood at 20.27% YoY, a 21bps increase from 20.06% YoY in May 2023. This was primarily driven by increased prices of air and road transport services, gas, vehicle spare parts, fuels, lubricants for personal transport equipment, and medical services. On a month-on-month comparison, the headline and food index sustained their northward trend rising by 2.13% and 2.40% in June 2023 (vs 1.94% and 2.19% in May 2023), respectively. Surprisingly, the core index grew at a slower pace by 1.74% in June 2023 from 1.81% in May 2023. As a result of this uptick and in tandem with the Central Bank's focus on price stability, we expect the monetary policy committee in its next meeting (25th of July) to maintain its hawkish stance and raise the monetary policy rate by 50bps.

Consumers Grapple with Higher Food Prices

Asides from the continued structural challenges in the agricultural food chain, developments in the domestic economy further added pressure on food price stability. Specifically, the removal of fuel subsidy engendered an increase in the cost of Premium Motor Spirit (PMS) and in turn led to higher transportation costs of food items; the festive celebrations, as well as the continued tomato supply crunch, have altogether created additional strain on food prices and led to the uptick in prices.

In the near term, we expect food inflation to remain elevated as the drivers of high prices are still present. Additionally, Russia's suspension of the Black Sea Grain Initiative poses an upside risk to food inflation, as prices of food items, especially grains and oils are expected to skyrocket following a global supply chain disruption.

Energy Prices to Maintain Upward Trajectory

The marginal increase in the core index came in as a positive surprise as we anticipated a more severe northward impact due to the c.170% surge in PMS prices. This is further buttressed by the fact that past less severe increases in the PMS prices have led to a higher magnitude of increase in the core index. Thus, the MoM decline in the core inflation (1.74% in June vs 1.81% in May 2023) is largely unreflective of major happenings in the month. Moreover, the collapse of official FX windows which led to a 66.50% devaluation of the currency as of the end of June, had a less severe impact on the core index. This is because the parallel market has been a major source for importers and manufacturers who are unable to access the official window.

Looking ahead, we expect core inflation to maintain its uptrend in the coming months. We project that the effect of higher PMS prices should be more reflected in July's inflation numbers. In addition, our anticipation of further currency depreciation is expected to increase energy costs due to its import dependency. While we expect an increase in money supply due to the reduction in Cash Reserve Ratio (CRR) debits for merchant banks to 10%, we expect a minimal impact on inflation figures as the funds will majorly be directed toward capital projects.

MERISTEM

Contact Information

Investment Research

damilareojo@meristemng.com (+234 816 890 2771)
praiseihansekhien@meristemng.com (+234 817 007 1512)
research@meristemng.com

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

Meristem Research can also be accessed on the following platforms:

Meristem Research portal: research@meristemng.com
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