MERISTEM

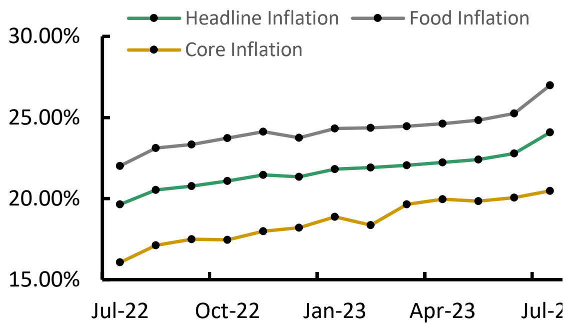
Macroeconomic Update

Inflation Report for July 2023

Key Summary Statistics

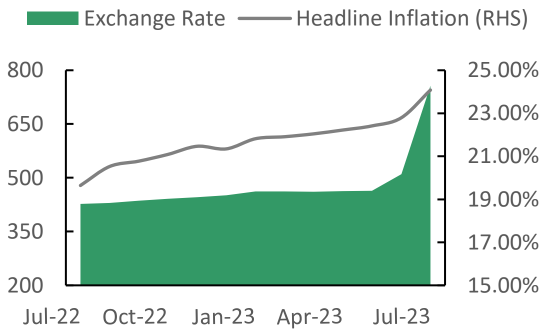
Category	July-2023	June-2023	July-2022
Headline inflation	**24.08%**	**22.79%**	19.64%
Food inflation	**26.98%**	**25.25%**	22.02%
Core inflation	**20.47%**	**20.06%**	16.06%
Imported Food inflation	**19.94%**	**19.10%**	17.91%

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



Source: NBS, Meristem Research

Chart 2: Movement in Exchange Rate NGN/USD and Headline Inflation



Source: NBS, FMDQ, Meristem Research

The National Bureau of Statistics (NBS) reported the headline inflation rate for July 2023 to have increased by 129bps to 24.08% YoY (from 22.79% YoY in June 2023). While we anticipated an uptrend, the inflation outcome is 43.00bps above our forecast of 23.65%. We note that the July data also reflects the effect of the petroleum subsidy removal in May and the resultant increase in prices of human and merchandise transportation in the subsequent months. Unsurprisingly, both the food and core indexes ticked up. The food index increased by 26.98% YoY (vs 25.25% YoY in June 2023), driven by higher prices in food items like oil and fat, bread and cereals, fish, potatoes, yam and other tubers, fruits, meat, vegetables, milk, cheese, and eggs. The core index also increased by 41bps (20.47% YoY vs. 20.06% YoY in June 2023). We note that the NBS reconstituted the core index to exclude energy for the first time due to the price volatility of energy products prompted by the removal of fuel subsidy and FX devaluation. Key drivers of the core index included prices of passenger transport by air, passenger transport by road, vehicle spare parts, medical services, and maintenance and repair of personal transport equipment. On a month-on-month basis, headline inflation surged by 2.89%. Also, both the food and core indexes were up by 3.45% and 2.11% (vs. 2.40% and 1.77% in June 2023), respectively.

Legacy Issues and External Factors Fuel Food Prices Escalation

During the month, the upward trajectory of food prices persisted due to ongoing challenges in the economy's food production sector (such as adverse weather conditions and poor storage facilities for agricultural produce). Additionally, the surge in Premium Motor Spirits (PMS) prices during the month increased logistics costs for agricultural produce, thus contributing to higher prices across various food items.

In the near term, we emphasize that the underlying challenges within the food sector remain prevalent, and thus food inflation will continue to trend higher. Moreover, the escalating conflict between Russia and Ukraine, combined with crop losses in agricultural regions spanning North and South America, Europe, and Australia (due to unpredictable weather conditions), presents a substantial upward risk to food inflation. Additionally, India (c.40% of global rice exports) banned the exports of non-basmati white rice, citing mounting food prices, elevated inflation, and concerns of rice scarcity attributed to El Niño disruptions. We expect this to further raise the price of the important food staple.

Core Inflation Maintains an Upward Trend

On the back of the FX devaluation (which led to higher prices of import-dependent items like mineral fuels, machinery, plastic articles, and pharmaceutical products), the core inflation rate increased to 20.47% YoY and 2.11% MoM. This represents the highest MoM increase since February 2012. We note that both the official and parallel market FX rates depreciated by 98.42% YoY and 22.30% YoY in July, respectively, impacting the core index negatively. We also note that the prices of energy products increased in the month, propelled by both deeper supply cuts and persistent European tensions – *which led to higher global crude oil prices (+7.04% MoM* – and the impact of the FX devaluation on energy products. In response, the Nigerian National Petroleum Corporation (NNPC) increased PMS prices from NGN537.00 to NGN617.00 per litre. Thus, the Energy sub-basket ticked up by 35.24%YoY in July 2023 (vs. 25.55% in July 2022).

In our view, core inflation will remain elevated in the near term in light of the continued free-fall of the Naira. The outlook of the FX market is largely marked by uncertainty and volatility; as such, there is an urgent need for a unified strategy to address these challenges, involving enhancing FX liquidity, promoting export diversity, and fostering investors' confidence through transparent policies. We think the energy sub-basket will continue its uptick on the back of tighter oil supply conditions with deeper OPEC+ cuts. On a MoM basis, we expect that core inflation will likely be declining as the repricing of essential items has already occurred.

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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:

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