NIGERIA | MACROECONOMIC UPDATE | INFLATION | INSIGHTS

FUNDAMENTALS

NIGERIA CPI UPDATE: A BREWING STORM

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IN BRIEF

- The headline inflation rate in Nigeria continued its upward trend for the fourth month in a row, rising to 22.4% y/y in May 2023 from 22.2% in April 2023. The sustained uptick in Nigeria's inflation remains consistent with market expectations, given the supply chain issues in the agricultural zones amidst FX challenges.

- Food inflation (24.8%), which accounted for 11.6% of the headline inflation, continues to fuel the momentum in general price levels. Supply chain bottlenecks, high fuel price and the devaluation of the naira on the parallel market explain the pressure on food prices.

- The removal of fuel subsidies at the end of May 2023 resulted in the tripling of domestic ex-pump prices, leading to skyrocketing transport fares and higher food and electricity prices. We believe that this pressure is not fully perceptible in the May 2023 inflation figures due to the time differential between the policy implementation and the May 2023 CPI data.

- We foresee elevated price pressures ahead as we expect the removal of fuel subsidies and the unification of the Naira exchange rates to heat up price pressures in 2H2023.

- While we maintain that Nigeria's inflation is mostly driven by non-monetary factors, the heightened upside risk emanating from the ongoing reforms raises our expectation that the Monetary Policy Committee will continue on its hawkish path. However, we do not rule out a "hold" decision after President Tinubu signalled lower interest rate expectation in his inauguration speech.

A persistent trend

The headline inflation rate in Nigeria continued its upward trend for the fourth month in a row, rising to 22.4% y/y in May 2023 from 22.2% in April 2023. The sustained uptick in Nigeria's inflation remains consistent with market expectations, given the supply chain issues in the agricultural zones amidst FX challenges.

Similar to previous months, food inflation, which accounted for 11.6% in headline inflation continues to drive overall inflation. Food inflation was up 21bps to 24.8% y/y, driven by higher inflation for Oil & fat, Tubers, Bread & cereals, vegetables, Fish, and Meat. We believe the lingering supply chain bottlenecks, high fuel prices and the devaluation of the naira on the parallel market underpinned the pressure on food prices.

Given the pressure on food prices, core inflation, which excludes the prices of volatile agricultural produce, inched down by 8bps to 20.1% y/y. Despite the slight decline, core inflation remains quite elevated in May 2023, screening 520bps above its level in the same period last year and 780bps above its 5-year historical average. This indicates persistent underlying prices pressures, which could intensify in the months ahead due to the ongoing reforms.

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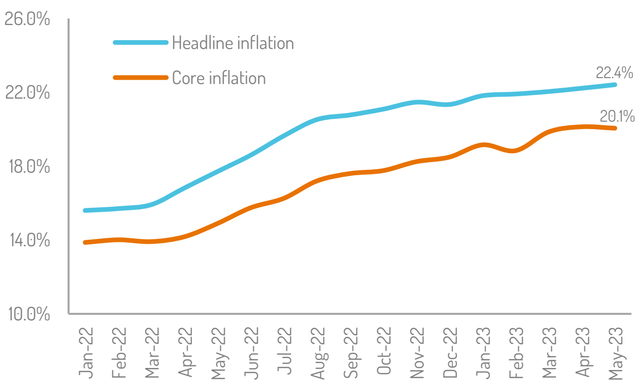
Core inflation vs headline inflation, Year-on change (%)



Source: National Bureau of Statistics

An inflation storm is in sight

Nigeria's new administration, led by President Bola Tinubu, aims to reform the Nigerian economy as reflected in the two major actions already undertaken. In particular, the authorities have removed fuel price subsidies and commenced the unification of the exchange rate market to allow a market-determined single FX rate. On 15 June 2023, the Investors & Exporters (I&E) rate was devalued to N632.77/USD and closed trading at NGN770/USD on 19 June 2023, broadly aligning with the parallel market rate of NGN750/USD.

We foresee elevated price pressures ahead as the resultant upsurge in fuel prices and transport fare filter through to consumer price inflation. We also expect the higher FX rate to increase utility tariffs in the near-term, intensifying the upside risk to Nigeria's inflation in 2H2023.

However, we think the direct impact of the new FX policy on imported food prices will be modest as importers of selected food items already dealt their forex transactions at the parallel market due to their exclusion from CBN FX sales.

Near-term monetary policy outlook appears to favour the hawks

The Central Bank of Nigeria raised the Monetary Policy Rate (MPR) by 50 basis points in May 2023 to 18.5%, continuing its rate hiking cycle which commenced in 2022. While we maintain that Nigeria's inflation is mostly driven by non-monetary factors, the heightened upside risk emanating from the ongoing reforms raises our expectation that the Monetary Policy Committee will continue on its hawkish path. However, we do not rule out a "hold" decision after President Tinubu signalled lower interest rate expectation in his inauguration speech.

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