NIGERIA | MACROECONOMIC UPDATE | INFLATION | INSIGHTS

FUNDAMENTALS

NIGERIA'S JULY 2023 CPI UPDATE:

DARK AND STORMY

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IN BRIEF

- Nigeria's headline inflation continued its ascent to all-time highs, surging 129bps to 24.1% y/y in July 2023. The surge in headline inflation reflects the pass-through of reforms-induced cost pressures and FX volatility, whose impact was muted in the June 2023 CPI data due to time lag effect.

- Unsurprisingly, food inflation accelerated by 173bps to 27.0% y/y and accounted for 12.5% of the headline inflation for July 2023, the most significant share. We also observed strong pressures from cost-push factors, on account of the fuel subsidy removal and transport fare hikes, which had a domino effect on distribution of farm produce.

- Although the high and rising core inflation (20.5% y/y) emphasizes the underlying price pressures, we believe the relatively lower uptick (without food CPI) underscores the uncertainty around food prices with continued near-term risks to the upside. Russia's suspension of the Black Sea Grain Initiative amidst the El Nino weather concerns will contribute to fueling imported food inflation while the persistent security challenges continue to disrupt local food supply chains.

- On the forex market, we believe market concerns around the low FX reserves (adjusted for encumbrances) will continue to weigh on the Naira in the near-term, with upside risk to CPI inflation.

- While persistently volatile FX suggests continued monetary tightening, the token hike in the policy rate in July 2023 signalled the MPC's admission of stronger influence from non-monetary drivers of inflation. Against this backdrop, we believe the next MPC decision will be complicated by cost-push and supply-side factors amidst the FX pressures.

Inflation hit new highs

Nigeria's headline inflation continued its ascent to all-time highs, surging 129bps to 24.1% y/y in July 2023. The latest uptick represents the seventh straight increase following the unexpected decline in December 2022.

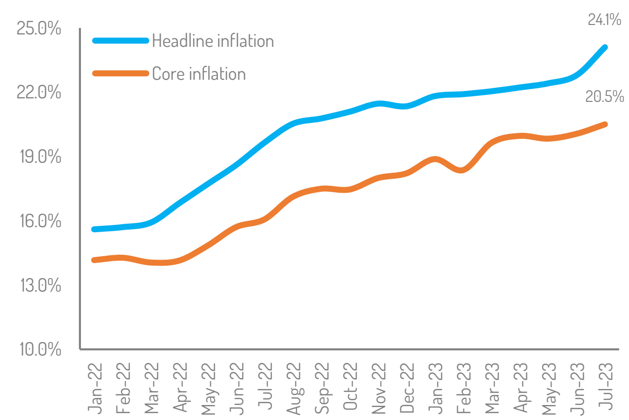
The surge in headline inflation reflects the pass-through of reforms-induced cost pressures and FX volatility, whose impact was muted in the June 2023 CPI data due to time lag effect. Unsurprisingly, food inflation accelerated by 173bps to 27.0% y/y and accounted for 12.5% of the headline inflation for July 2023, the most significant share. This rise in food inflation was underpinned by price pressures for Oil and fat, Fish, Potatoes, Tubers, Bread & cereals, vegetables, Fish, and Meat.

We observed strong pressures from cost-push factors on account of the fuel subsidy removal and transport fare hikes, which also had a domino effect on distribution of farm produce. Transport inflation (26.3% y/y) surged by 144bps while inflation for utilities, gas & other fuel rose to 19.9% y/y (+140bps). Together, the Transport and Utilities inflation accounted for 5.6% of the headline rate of 24.1%.

The raging food storm underscores near-term uncertainty

Core inflation (overall CPI excluding the volatile energy and farm produce price) also edged up 41bps to 20.5% y/y in July 2023. Although the high and rising core inflation emphasizes the underlying price pressures, we believe the relatively lower uptick (without food CPI) underscores the uncertainty around food prices with continued near-term risks to the upside.

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



Source: National Bureau of Statistics

Russia's suspension of the Black Sea Grain Initiative amidst the El Nino weather concerns will contribute to fuelling imported food inflation while the persistent security challenges continue to disrupt local food supply chains.

In August 2023, the Federal Government approved a palliative package of NGN 5.0bn (USD 444.0mn) - cumulatively NGN 185bn – to enable each state procure food items for distribution to the vulnerable population. We expect this short-term measure to ease the cost burden on the 25.3 million Nigerians estimated by the Food and Agriculture Organisation as being at risk of acute food insecurity between June and August 2023. However, we do not believe that these palliatives will sufficiently ease the supply chain and price pressures at the macro level. At the start of implementation, we observe concerns stemming from distribution hitches, alleged underhand dealings, and inadequacy of materials. We expect these implementation challenges to dampen the benefits of the palliative package and sustain the food price pressures with upside risk to headline inflation in the near-term.

On the forex market, the acute FX shortage continues to fuel Naira volatility with a widening spread between the official and parallel market rates, following the brief convergence achieved in June 2023. The official rate closed trading at NGN 761.3/USD as of 21 August 2023, compared to N858.0/USD on the parallel market. The USD 3.0bn loan from Afrexim bank by the Nigerian National Petroleum Company (NNPC) provided temporary relief on the parallel market. However, we believe market concerns around the low FX reserves (adjusted for encumbrances) will continue to weigh on the Naira in the near-term with upside risk to CPI inflation.

The monetary policy outlook appears hazy on cost and supply-side factors

The Monetary Policy Committee (MPC) delivered a token hike of 25bps to its Monetary Policy Rate (MPR) to 18.75% at its July 2023 MPC meeting, in line with our expectations. We believe the modest rate hike reflects the Committee's desire to leave a window of support for the real sector amidst lingering structural impediments to supply side. While persistently volatile FX suggests continued monetary tightening, the token hike in the policy rate in July 2023 signalled the MPC's admission of stronger influence from non-monetary drivers of inflation. Against this backdrop, we believe the next MPC decision will be complicated by cost-push and supply-side factors amidst the FX pressures.

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