

Inflation hits a ceiling, set to decline marginally to 15.5%

After an almost unstoppable rise in headline inflation to a record high, the economy may be entering an era of disinflation or declining rates of inflation. We are projecting inflation in June to drop from 15.6% to 15.5%. If this estimate turns out to be accurate, it will raise some fundamental questions as to the direction of inflation and possible level of interest rates in the money markets

Headline inflation in Nigeria had almost been a loose cannon, defying most rules of economic gravity and logic. The root cause of the near hyper inflation rate can be traced to supply shocks at-times attributable to artificial scarcity compounded by uncertainty in the forex markets.

The Big question therefore is whether this drop in inflation is a blip or a point of inflection.

Adaptive Expectations Theory

Economic history has shown that disinflation (a period of declining inflation) is usually a result of adaptive expectations. The theory of adaptive expectations assumes that people form their expectation of future inflation on the basis of previous and present rates of inflation and gradually change their expectations as experience unfolds.

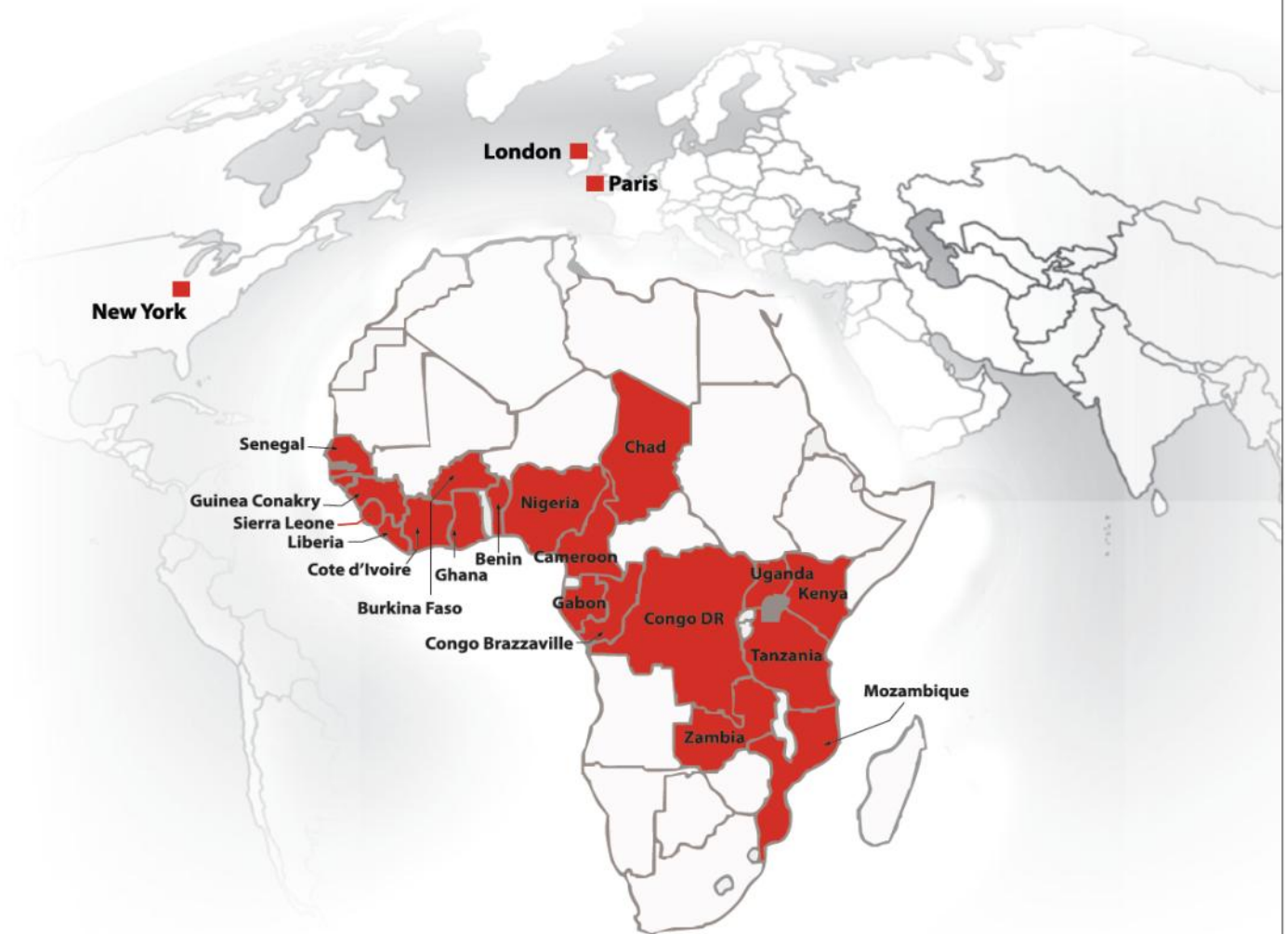
The theory was advanced and popularized by Milton Friedman, the Nobel economist from the University of Chicago.

This theory is applicable in Nigeria today because of the price trend since February. Consumers increased their demand for products out of unavailability and fear that prices will continue to skyrocket. But by April through May, aggregate demand curve had shifted inwards because of the income constraints.

This coincided with the month of May's subsidy removal (slashed purchasing power) which altered consumer behavior. The game changer however was the new exchange rate policy which effectively reduced disposable income by 40%.

Therefore in spite of perceived scarcity and cost pressures, consumer resistance became the spur for the adaptive expectations theory to take sway in Nigeria.

Africa... United by One Bank



We know our way around finance in Africa

United Bank for Africa Plc is one of Africa's leading financial institutions offering banking services to more than 7.5 million customer accounts across 750 business offices in 19 African countries. With presence in New York, London and Paris, UBA is connecting people and businesses across Africa through consumer and corporate banking, innovative cross-border payments, trade finance and e-banking.

■ Africa

● New York

● London

● Paris

When you look at consumer price movement, the anecdotal evidence shows that more price elastic commodities hit a brick wall and started declining in June. Tomatoes, maize and rice moved slower. Price inelastic commodities like beans remained flat.

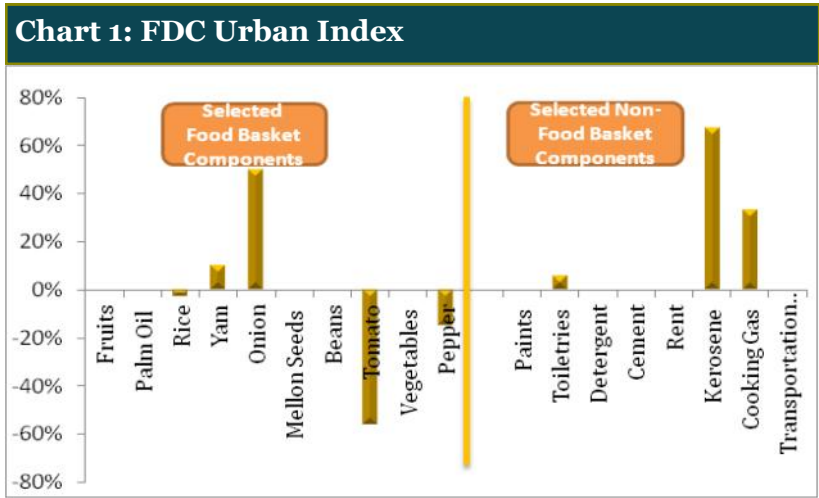
Table 1 : Commodity Price Changes

Commodities	May (N)	June (N)
Tomatoes (Basket)	40,000-45,000	20,000-25,000
Pepper (Basket)	20,000	17,000
Maize	18,200	12,800
Rice (50kg)	14,500	13,000
Beans	16,000	16,000

One outlier product is the price of diesel which has increased by almost 100% from 107 per litre in March to N210 per litre presently. This is mainly because of the abysmally low power output from the national grid, which has pushed demand to record levels. The impact of this high diesel price is pushing distribution and transportation cost to stratospheric levels. We have also seen a sharp spike in the prices of kerosene and cooking gas. These are all scarcity propelled because importers switched from kerosene and diesel to PMS. We are now seeing a swing to the end of the product pendulum again. We expect the price of diesel to crash in August back to the N120-N130 per litre levels.

Urban Price Movement

The FDC Lagos urban inflation index decreased by 0.84%, from 11.23% to 10.39%. This was driven by the decrease in both the food and non-food baskets. The year-on-year (YoY) food index decreased to 15.08% from 15.33%, while the YoY non-food index increased to 9.28%, from 9.04% in April.



Source : FDC Think Tank

Regional Inflationary Trend

The trend of declining inflation rates in SSA seems to be more pronounced in the last quarter. The average rate of inflation in the continent is 9.4% in 2016, with Nigeria high up among the top 10 countries. The highest rate of inflation in SSA is now South Sudan with 295%. Angola, the highest oil producer in Africa is witnessing an inflation rate of 29.23%. It has just called off talks with IMF to support its balance of payments adjustment program. It has also increased its benchmark interest rate to 16%, up 200bps. Other countries like Cameroon, Ethiopia and Gabon that are experiencing falling rates of inflation are enjoying the benefits of forward looking and market oriented reform policies.

Impact Of Declining Inflation On Policy And Markets

Interest Rates

The MPC is scheduled to meet on the 25th - 26th of July. They will be closely monitoring the inflation data. A lower inflation number will ease the pressure on the policy makers. However, a precipitated move such as lowering rates is an unlikely outcome at this meeting. The market is still digesting the impact of the N1.3trillion debit for the \$4.02billion forward sale. The macro-prudential risks arising from the regulatory action against the Board of Skye bank is leading to a flight for safety/quality banks. This has led to a further segmentation of the industry along the lines of perceived risks. In aggregate, we see an upward shift in interest rates move out of the risk mitigation attitude of the market than as a result of the inflation data.

MHF PROPERTIES LIMITED

"Where Quality Living Exceeds Expectations"
3B Osborne Road, Ikoyi, Lagos, Nigeria
01- 8418662, 0802 342 3874, 0705 400 6101
info@mhfproperties.com
www.mhfproperties.com

FOR LEASE

MARIYA COURT

Location: 2B, Probyn Close, Ikoyi, Lagos

Amenities:

1. All rooms fitted with new air conditioners
2. Intercom system
3. Equipped kitchen with electrical cooker/oven, fridge, deep freezer and washing/drying machine.

Other Facilities:

1. Gym, squash court, steam bath, sauna, swimming pool with bar and barbeque stand
2. 24hrs power supply
3. 24hrs security/CCTV/Alarm system
4. 24hrs Technician on duty
5. Fully equipped play area for children



RHAMA GARDEN

Location: 28, Gerard Road, Ikoyi, Lagos

Amenities:

1. All rooms fitted with new air conditioners
2. Intercom system
3. Equipped kitchen with electrical cooker/oven, fridge, deep freezer and washing/drying machine.

Other Facilities:

1. Gym, squash court, steam bath, sauna, swimming pool with bar and barbeque stand
2. 24hrs power supply
3. 24hrs security/CCTV/Alarm system
4. 24hrs Technician on duty
5. Fully equipped play area for children



Exchange Rate

The naira is still trying to find its true value in the transition from an imperfect towards a more efficient forex market. The apparent lack of liquidity in the spot market is hampering the effective development of a forward and futures market. A 0.4% decline in the rate of inflation will be exchange rate neutral. The market will be awaiting the outcome of the next monetary policy committee direction. It will also be looking forward to CBN's willingness and ability to settle the 90-day forward contracts entered into on June 20th; maturing on September 17th. However, analysts will derive some comfort from a lower inflation rate because the Purchasing Power Parity value of the Naira will actually appreciate.

Capital Market

The stock market has benefited from the positive sentiment arising from a shift towards a market oriented forex and petroleum pricing policy. The market was pricing in the anticipated inflow of portfolio funds from international institutional investors. A decline in inflation will be market positive because it reduces the probability of an increase in the benchmark rate which could depress asset prices in the short-run. In the end the market is going to be driven more by corporate earnings and financial fundamentals.

Important Notice

This document is issued by Financial Derivatives Company. It is for information purposes only. It does not constitute any offer, recommendation or solicitation to any person to enter into any transaction or adopt any hedging, trading or investment strategy, nor does it constitute any prediction of likely future movements in rates or prices or any representation that any such future movements will not exceed those shown in any illustration. All rates and figures appearing are for illustrative purposes. You are advised to make your own independent judgment with respect to any matter contained herein.

© 2016. "This publication is for private circulation only. Any other use or publication without the prior express consent of Financial Derivatives Company Limited is prohibited."