

# FDC Economic Bulletin

June 08, 2016

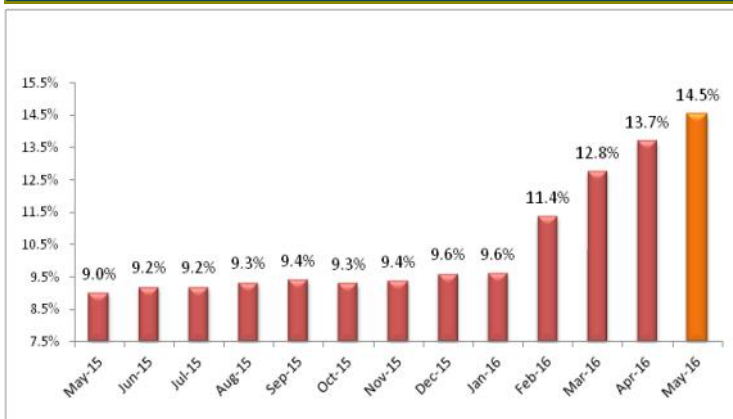
## *Inflation Up Again - A Never Ending Problem*

We are estimating a spike in YoY inflation to 14.5% in May, 0.8% higher than that of April. If accurate, this will be the fifth consecutive monthly increase in inflation and the highest in nearly six years.

May 2016 was an interesting month in which a series of defining events took place. These factors, alongside the traditional cost-push factors, pushed inflation higher. They include:

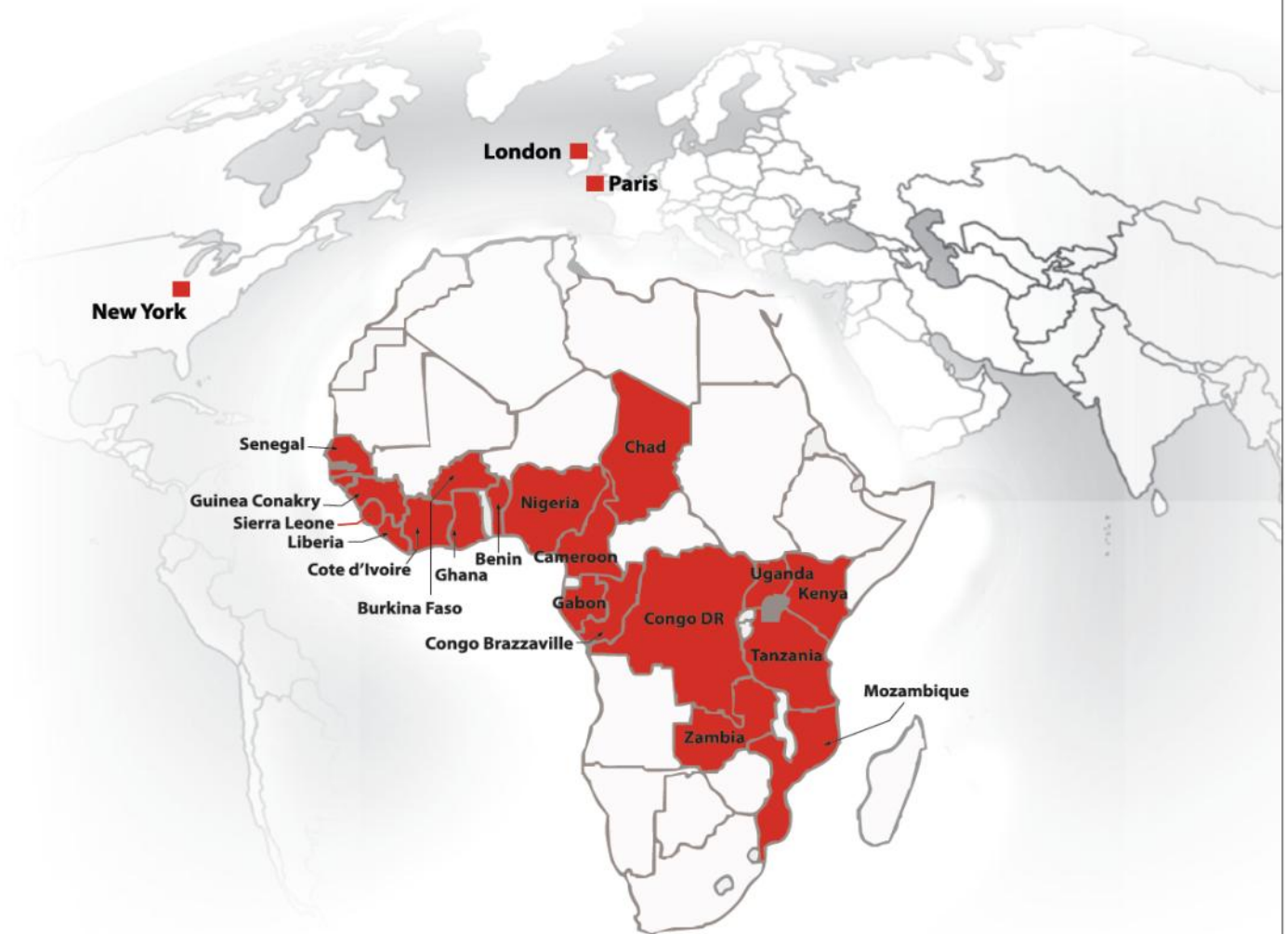
- The nominal price of the PMS was increased by 68% to N145, though the average price across the country was already N162.
- The naira depreciated from N320/\$ to N350/\$ following the announcement of a flexible exchange rate. This has widened the premium between the IFEM and BDC by 75.9%. The unavailability/uncertainty premium has been the driving force behind the steep pace of increase in inflation since February.
- Scourge of the tuta absoluta significantly reduced tomato supply, sending prices to a record high of N45,000 per basket.
- The price of diesel increased by more than 20%. This was because of poor power supply in May as well as a decrease in the supply of diesel. Additionally, suppliers have decreased trading diesel in favour of the higher-margin PMS. Diesel is used to power trucks that transport agricultural products from the rural to urban areas.

**Chart 1: Headline Inflation Rate**



Source : NBS, FDC Think Tank

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*We know our way around finance in Africa*

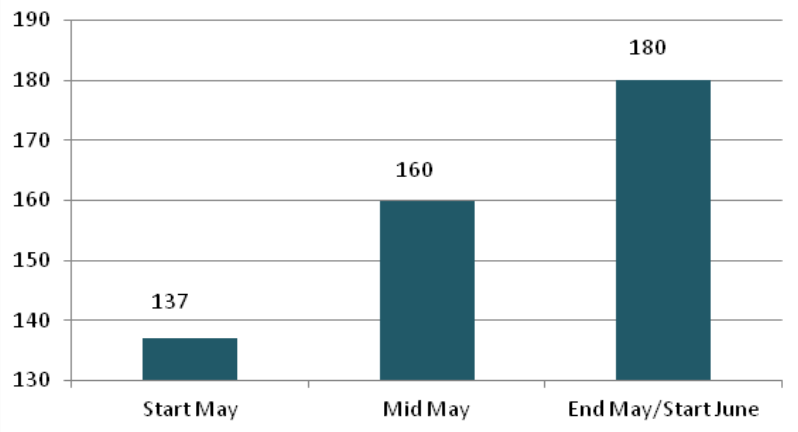
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**Chart 2: Diesel prices (N/ltr )**

Source : FDC Think Tank

Inflation this year is devoid of wage pressure. Labour unions have made ludicrous demands of approximately 200% wage increase. This is at a time when labour productivity growth is at (-0.4%) according to the EIU. Inflation has been muted by strong consumer resistance due to falling discretionary income. The consumer resistance has been evident as shown in declining fuel demand, reduced shopping mall traffic and decreasing passenger load factors.

The CBN's plan to adopt a flexible exchange rate regime implies a possible reduction in the uncertainty that has been a fixture in the forex market. The delay in releasing the details of the new forex framework is causing heightening uncertainty in the forex and capital markets.

## **Inflation likely to remain high in June**

We are projecting that the rate of inflation will slow down in June because of a contraction in money supply. This will be reinforced by the sharp reduction in disposable income, the commencement of the rainy season and early harvest.

## **Urban prices accelerated moderately in April**

The FDC Lagos urban inflation index decreased by 0.03%, from 11.26% to 11.23%. There was a slowdown in price increase as the rate of increase (YoY) between April and May was not as high as that between March and April.

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.



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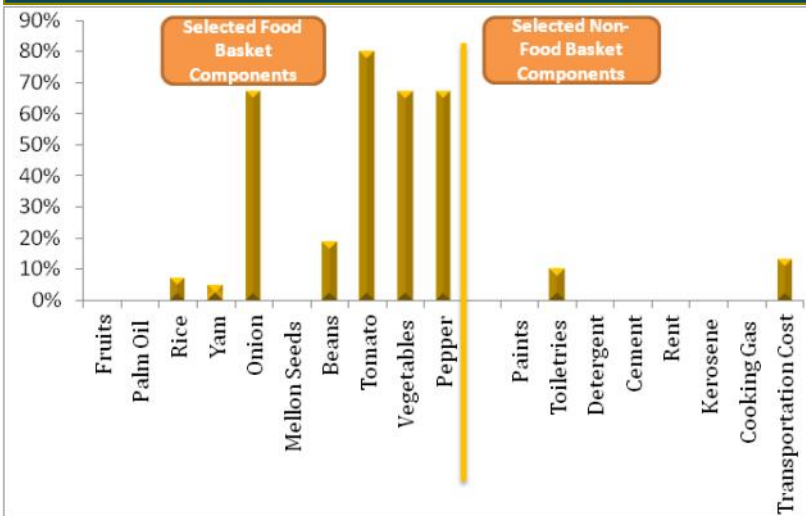
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**Chart 3: FDC Urban Index**



Source : FDC Think Tank

### Regional Inflationary Trend

The average inflation rate across Africa is 10.8%. The inflationary trend across SSA is generally a mixed bag. The countries that witnessed higher price levels include Angola and Uganda. Angola’s inflation rate increased from 23.6% to 26.41% in April, the highest in 11 years. It was driven by imported inflation due to a weakened currency. Uganda’s inflation rate rose for the first time in 2016 from 5.1% in April to 5.4% in May. This increase in price levels was fuelled by higher core inflation.

Countries that had a slowdown in inflation include Ghana, Kenya and South Africa. Ghana’s inflation rate declined to 18.7% in April from 19.2% in March due to a slower increase in the price of housing, utilities, food and transport. Kenya’s inflation rate eased to 5% in May from 5.27% in April. This decrease was due to a slowdown in food prices, housing and utilities. Furthermore, South Africa’s inflation rate was 6.2% in April, down from 6.3% in March. The decline in inflation rate was mainly due to lower petrol costs.

### Likely Market Response

#### Interest Rates

Interbank interest rates have been trading between 2.5% and 5% in recent times due to increased liquidity. If inflation increases further, negative real returns will be higher. The market does not expect an increase in benchmark interest rates as policy makers seem focused on stimulating growth.

## Exchange Rate

The uncertainty in the forex market, as well as forex shortage, still continues to feed into inflation. An adoption of a flexible exchange rate will help stabilize the forex market and remove the uncertainty that has pushed prices up.

## Capital Market

The NSE ASI appreciated due to the announcement of a flexible exchange rate framework. However, the Nigerian equities market has recorded losses in the past few days due to delay in the release of the guidelines for the flexible foreign exchange rate policy. In the fixed income market, bond rates have remained between 13% and 14% in recent weeks. Thus, we do not expect any significant changes unless liquidity varies considerably.

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