FDC Economic Bulletin

June 14, 2016

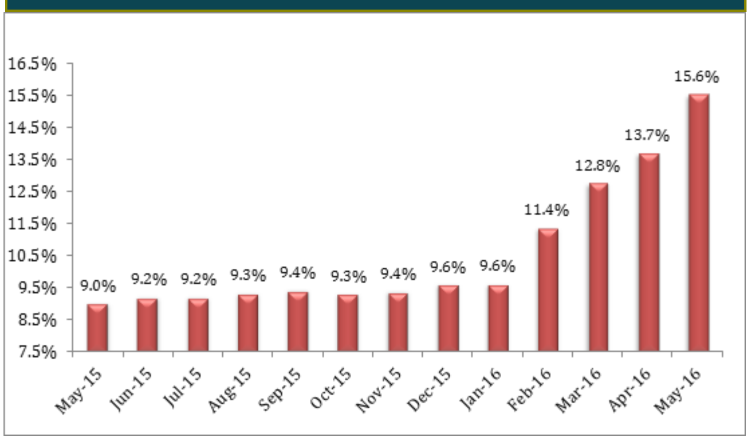
Inflation soars to a 6-year high of 15.6%

Analysts' consensus was for a CPI spike of 14.5%, the reality and magnitude of the spike to 15.6% was surprising. FSDH was accurate in its inflation forecast. This is the highest price level in Nigeria since February 2010. The inflation trajectory rose sharply since February 2016 when it spiked to 11.4%. The current inflation spiral has been caused by both fundamental cost pressures, periodic scarcities of essential commodities and forex unavailability. The pricing pass through has been mixed but mainly in price inelastic commodities. The transmission effect on consumer prices was elevated mainly by an astronomical jump in the price of diesel from N130 per litre to N185 per litre. Diesel fuel is critical to distribution and logistics in the delivery of goods to the market. It also explains the widening differential between rural and urban inflation.

The monetary policy authorities at their last meeting refused to tighten further by leaving the MPR unchanged. It preferred to support growth because of the fears of an impending recession.

The inflation data for May showed a month-on-month increase of 1.2% in consumer prices from 1.6% in April to 2.8% in May. Both food and core inflation increased by 1.7% (YoY) in May. Urban inflation (YoY) rose by 2.1% while rural inflation increased by 0.7%.

Chart 1: Headline Inflation Rate



Source : NBS

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Factors driving inflation rate

Inflation expectations remain pessimistic as current developments in the economy continue to stoke inflationary pressures. Most notable of these factors are

- Increase in the nominal price of PMS by 68%
- Continued depreciation of the naira from N320/$ to above N350/$
- Food shortages
- Poor power supply

Structural bottlenecks in energy, power and logistics sectors still continue to impede productivity. These factors, combined with uncertainty in the country's macroeconomic direction, are eroding investor and public confidence.

The May Data

An analysis of the NBS inflation report shows that both the food and core indices increased at a similar pace by 1.7% (YoY). Food inflation increased by 14.9% in May compared to 13.2% in April. The highest contributors to the increase in the food basket were fish, bread, cereals and vegetables. Imported food inflation was sharply higher by 2.2% in May to 18.6%. Electricity and energy costs also pushed the core index rate to 15.1% in May, 1.7% above April's.

Interestingly, the inflationary impact was more severe in urban areas than in rural areas. The urban index increased by 2.1%, from 15.1% in April to 17.2% in May. The rural index increased to 12.7% from 12.0% in April.

A cumulative mix of a spike in the pump price of petrol, government spending and a continued depreciation of the naira exaggerated price movements in May. Rates are expected to reflect market realities in the medium to long term.

The Impact

The impact of a consistent increase in prices is an erosion of value and confidence in economic agents. Whilst the nominal inflation has spiked, the trend shows a slowing of the rate of inflation.

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Fixed Income and Money market

With the economy grappling with negative growth, policy makers are unlikely to favour an increase in benchmark interest rates. Bond rates have settled in the region of 13% to 14% in recent weeks, and we do not expect any significant change in bond rates unless there is a sizable variation in liquidity or the exchange rate policy.

Stock market

The Nigerian bourse is still underperforming with a YTD return of (-5.37%). The uncertainty in the forex market is also adding pressure as investors continue to exit the stock market. With real returns entrenched in the negative region of (-3.6%), we expect investors to become more active in the fixed income market.

Inflationary outlook

Nigeria is likely to experience a high inflation environment for most of the year, albeit at a slower pace in coming months. The release of the forex policy guidelines will trigger an increase in consumer prices in June and July before correction takes place in Q4. In addition, the contraction in money supply, reduction in disposable income, rising consumer resistance and early harvest would dampen inflationary pressures.