

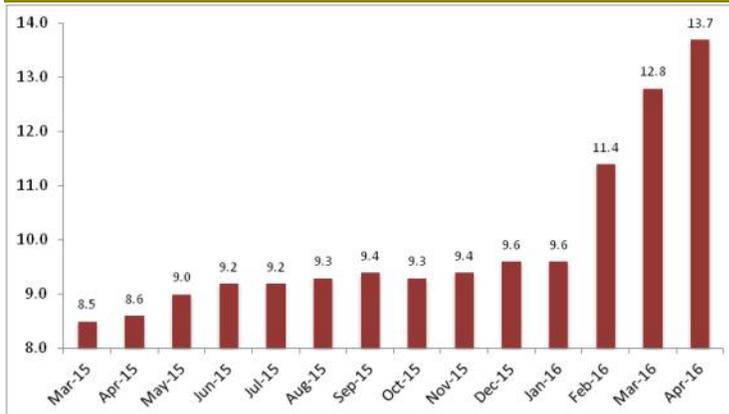
FDC Economic Bulletin

May 16, 2016

Headline inflation increases sharply again to 13.7%

In line with analysts' forecast, the headline inflation rate for April 2016 spiked to a record 13.7%, the highest level since August 2010. This inflation figure is a continuation of the trend of price spiraling that has become a source of concern to policy makers and the government. Headline inflation has spiked by 2.8% since February after a gradual but consistent climb in the CPI since 2015. April's inflation data showed that the month-on-month increase in consumer price level slowed down by 0.6% from 2.2% in March to 1.6% in April. A high interest rate environment has grave implications for a country that is grappling with slow growth and an underperforming stock market.

Chart 1: Headline Inflation Rate (%)



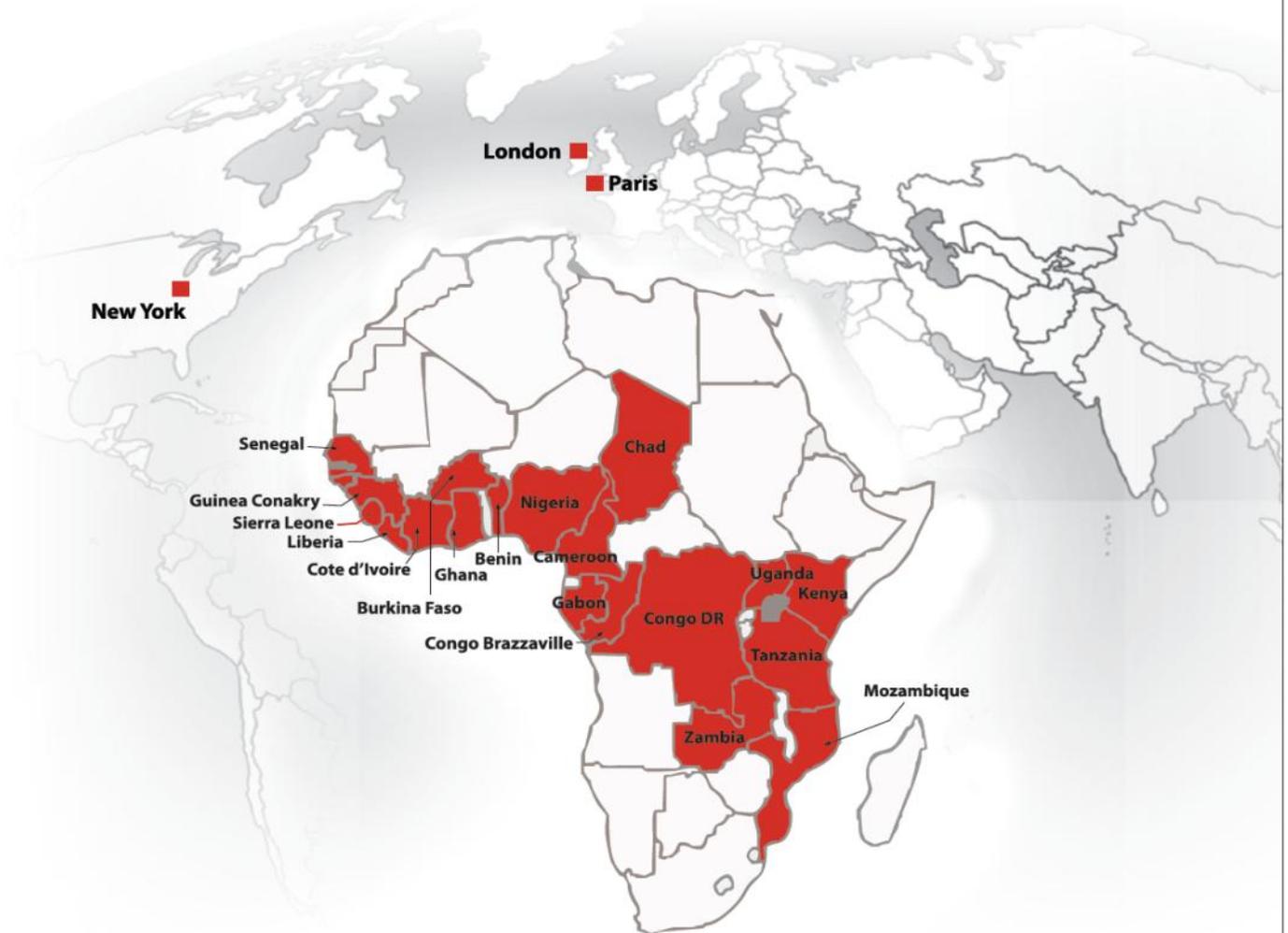
Source : NBS, FDC Research

Factors driving inflation rate

Inflation expectations have been pessimistic based on recent developments that have become more turbulent than usual, especially policy uncertainty and drifting.

- A 67.6% increase in petrol prices from N86.50 to N145 per litre
- Severe fluctuation in exchange rate, which has seen the naira depreciate to as low N355/\$

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- Persistent power shortages

Manufacturer and investor sentiments are also tilting towards the negative as these structural bottlenecks in the power, distribution, logistics and energy sectors have influenced stakeholder inflation expectations.

The April Report

An analysis of the NBS inflation report shows that the core index was the main driver of the jump in April's inflation rate. Higher fuel prices and electricity costs pushed the core index rate to 13.4% in April, 1.2% higher than in March. Imported inflation also had an inflationary impact on the core index as forex scarcity persisted. Food inflation increased by 13.2%, 0.4% higher than that of March. With the exception of fruits and tubers, other food groups increased during the month with the rise in imported food prices being a significant factor.

Furthermore, the inflationary impact was more severe in the urban areas than in the rural areas. The urban index increased by 1.6%, from 13.5% in March to 15.1% in April. The rural index increased to 12.8% from 12.0% in March.

In May 2016, a cumulative mix of a spike in the pump price of petrol, government spending and a 9.3% decline in exchange rate value from April 2016's average of N322/\$, illustrate a possible exaggeration of price movement. Nonetheless, in the medium to long term, rates should reflect market realities.

Impact of rising inflation on policies, the markets and overall economy

The high inflationary environment would have various impacts on policies, the markets and various economic agents. Some of these impacts include:

Fixed Income and Money market

The MPC is expected to seriously consider the consequence of high inflation on investor returns. A tighter monetary environment (hiking interest rates) could result in investors shifting to the fixed income market due to attractive interest rates. In addition, NIBOR and T-bill rates would be expected to increase.

Stock market

Given the underperformance of the stock market with a negative YTD return of (6.35%), we expect capital outflow from the Nigerian bourse, as investors become attracted to high interest fixed income instruments.

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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
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Monetary Conditions

The average opening position of banks in April of N423.58bn, confirms a situation of excess liquidity in the system. That coupled with petrol prices now at N145, a weak currency and inflationary pressures intensifying, the Nigerian labour union is agitating for an increase in minimum wage to N56,000. This is a 211% increase from the N18,000 minimum wage, which took effect in March 2011. Meanwhile, the cumulative average inflation rate between 2011 and 2015 is 48.6%. An increase in minimum wage will increase money supply, stoking inflationary pressures.

Inflationary outlook

Given the depreciation of the naira due to forex shortages, higher petrol prices, budgetary disbursements and reduced food supply due to planting season, we expect headline inflation to increase in May. Though increased spending in capital projects would have the countercyclical effect by increasing output, Nigeria would likely start benefitting from such investments in the medium to long term.

Monetary Policy Committee (MPC) Outlook

Nigerians are extremely nervous about the possible outcomes of the next MPC meeting. This is because of a confluence of negative developments ranging from a sharp fall in the production of oil, deepening external reserves, spiraling inflation and sharply lower GDP growth. There has hardly been a time in the history of Nigeria that the Central Bank has been faced with such stark and hard choices. Unfortunately, there is no silver bullet. We expect a cocktail of measures or a sequence of steps aimed at controlling inflation, maintaining currency stability and stimulating growth. The order in which these decisions will be taken is a subject of great uncertainty and anticipation.

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