FDC Economic Bulletin

September 9, 2016

Headline Inflation set to rise again to 17.6%

Our estimates show an increase in the year-on-year (YoY) headline inflation rate to 17.6% in the month of August from 17.1% in July. If accurate, this will continue the trend of a gradual slowdown in the rate of month-on-month (MoM) inflation witnessed in recent months. The increase in inflation rate was mainly due to forex scarcity and its resultant uncertainty premium, which led to further divergence between the interbank and parallel market rate. The reduction in the pace of consumer price increase was due to the harvest season, consumer resistance, price ease in the energy sector and improved power supply.

The base year effect manifests

According to our estimates MoM inflation is to decline to 0.5%, making this the lowest rate of MoM change since February. This is an important point to note as the MoM inflation rate presents a clearer picture of price movement towards the end of the year. This is because of the base year effect, where if the inflation rate in the corresponding period of the previous year, August 2015, is low, a minor rise in the price index produces a high inflation rate in the current period, August 2016. The current month-on-month inflation of 0.6% when annualized is 7.44%, thereby reflecting a base year effect of almost 10%. Therefore this bias embedded in the headline inflation rate makes MoM analysis more attractive.

What drove prices higher?

The naira depreciated to new lows in the parallel market, though the interbank market appreciated marginally. Given that the bulk of the funding for economic activities is sourced from the parallel market, the persistent depreciation of the naira is a major issue for Nigerian consumers and producers. The parallel market depreciated by 9.6% to N418/$ from N378/$ in July. The decline in the naira was precipitated by the CBN's ban on nine banks for withholding disbursement of NNPC/NLNG funds in the sum of $2.3bn to the Treasury Single Account (TSA). The settlement of forward contracts of $1.2bn also put further pressure

on external reserves and in turn dollar availability. The dysfunction of the forex market is triggering uncertainty given the CBN's inconsistent policies and actions.

Inflation dampening factors

Despite the general rise in consumer price levels, increased food supply and improved power generation are dampening inflationary pressures. Real wage inflation has yet to set in to compensate rising prices and as such consumers continue to adjust their spending habits in accordance to this reality. There has been no adjustment to income, and this resulted in increased consumer resistance as the economic outlook appears bleak.

Power generation improved by 19.5% to 3600MW from 3011MW in the month of July. This can be attributed to the improvement in hydropower generation due to heavy rains in August as well as a relatively lower rate of militant attacks on pipelines in the month compared to July, thereby easing threat to thermal power generation.

Diesel prices also eased in August to an average of N197.50/ltr from July's average of N206.55/ltr partly due to improved power supply. Hence, logistic and distribution challenges were marginally mitigated. PMS also witnessed a price ease from the government's price cap of N145/ltr to N143/ltr in some major filling stations.

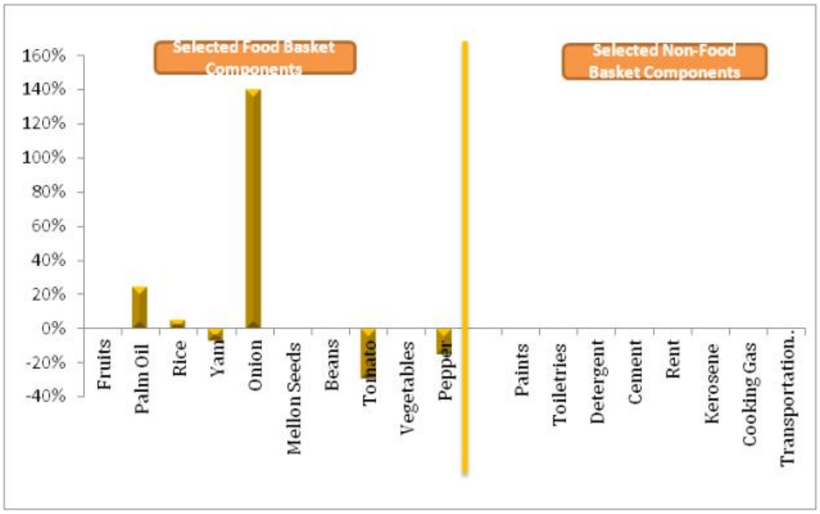
Chart 1: Headline Inflation Rate

Source : NBS, FDC Think Tank

Urban Price Movement

The FDC Lagos urban inflation index increased to 13.30%. This is 1.83% up from the July rate of 11.47%. This spike was mainly driven by base year effect on food prices as this year's harvest was not as abundant as last year's. The year-on-year food index increased to 17.85% from 13.99% in July while the non-food year-on-year index increased to 10.99% from 10.20%.

Chart 2: Month-on-Month Price Changes



Source : FDC Think Tank

Outlook for September

Our inflation outlook for September will include key events that have happened in the month. Air travel agencies are facing enormous challenges in servicing and purchasing aviation fuel. Air transport costs are expected to rise as fewer airlines are in operation. Furthermore, oil marketers are demanding an increase in pump prices to cover costs associated with foreign exchange differentials.

The recession, public outcry and necessity for stringent policies to elevate the economy have fuelled immense anticipation about the upcoming Monetary Policy Committee (MPC) meeting scheduled for 19th-20th September. In the wake of the previous meeting and the decision to hike MPR, interest rates have risen at an astronomical speed. Treasury bills yields are currently at highs of 14-20%. Hence, sterilising the money supply in the economy which is necessary to kick-start economic activity. Still on the money supply front,

27.5% of money supply is cut due to CBN regulations of a 22.5% CRR rate and a statutory rate of 5%. These are possible funding outlets for investment being constrained. Therefore deliberations would have to weigh the cost and benefits of further negative growth

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