FDC Economic Bulletin

January 11, 2017

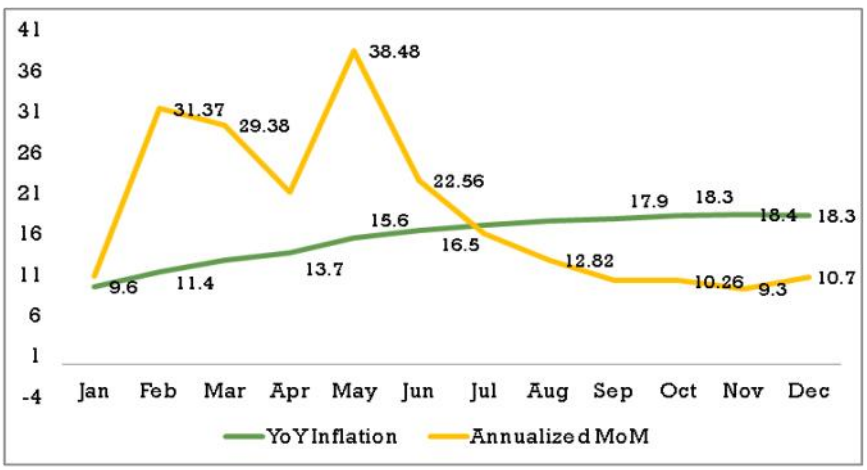
Headline Inflation Set to Decline to 18.3%, First Drop in 14 Months

Nigeria's headline inflation is forecast to slide to 18.3% in December, the first decline in 14 months. The direction of the inflation downwards will come as a relief to the monetary policy committee, which has been waiting for the change in trend for almost an eternity. After exhausting every arrow in its quiver, the Central Bank of Nigeria (CBN) had almost given up on the war against the indicator.

Even if estimates actualize and inflation declines, it is still a mile away from the CBN's comfort zone of 6-9%. A December decline coinciding with a sharp increase in the PMI is good news. It might be an indication that consumer resistance to retail price increases may be driving prices down. It might also project that a high inventory level and borrowing cost environment are coaxing producers to bring down their prices.

The change in headline trajectory may come as no surprise when some fundamental factors are considered. First when looking at drivers of inflation, apart from the Keynesian demand pull and cost push factors, monetary influences are another major factor to push up or contract consumer prices. There is a positive relationship between money supply growth and rising inflation. Therefore, a contraction in money supply will trigger a tapering of rising consumer prices.

Chart 1: Headline Inflation vs Month-on-Month Inflation (%)



Source : NBS, FDC Think Tank

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The income constraint and sustained increase in productivity in the agricultural sector, observed in the economy, also serve to reinforce the anticipated change in inflationary trend. While many other indicators have declined dramatically (e.g. purchasing power and the value of the naira) agricultural productivity has helped support gross domestic output with the sector enjoying two consecutive quarters of sustained positive growth.

The anticipated change in the inflationary trend can serve as good news to the Nigerian public who have sought respite from Nigeria's economic woes. However, there are certain core components of the consumer basket that may increase. Diesel prices have maintained a persistent increase, which in turn feeds into costs of production and logistics (cost push factors). Diesel prices were selling at an average rate of N260/ltr in December, up 62.2% YTD. This factor is likely to widen the divide between the rural and urban areas in terms of inflation, as urban inflation usually incorporates rural inflation plus transportation costs. In addition, financial costs are also ridiculously high and impeding output level. Manufacturers are servicing very expensive debts as well as operating in an environment with highly priced and sometimes unavailable loans.

Urban Price Movement

The urban index reinforces our forecast of a decline in headline inflation. The FDC Lagos urban inflation index decreased to 11.74% in December. This is a decrease of 0.72% from the November rate of 12.45%. The year-on-year food index decreased to 13.50% from 15.49% in November while the non-food year-on-year index decreased to 10.85% from 10.92%.

Chart 2: Month-on-Month Price Changes

Source : FDC Think Tank

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Monetary policy committee meeting

The monetary policy committee is projected to- meet on the 23rd and 24th of January. An anticipated decline in inflation could open up the floor to considerations for a more accommodative monetary policy stance. However, the likelihood that rates will be revised this January is slim, as the committee is very likely to adopt a wait and see approach to determine if this new development is the beginning of a trend or a flash in the pan.

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