FDC Economic Bulletin

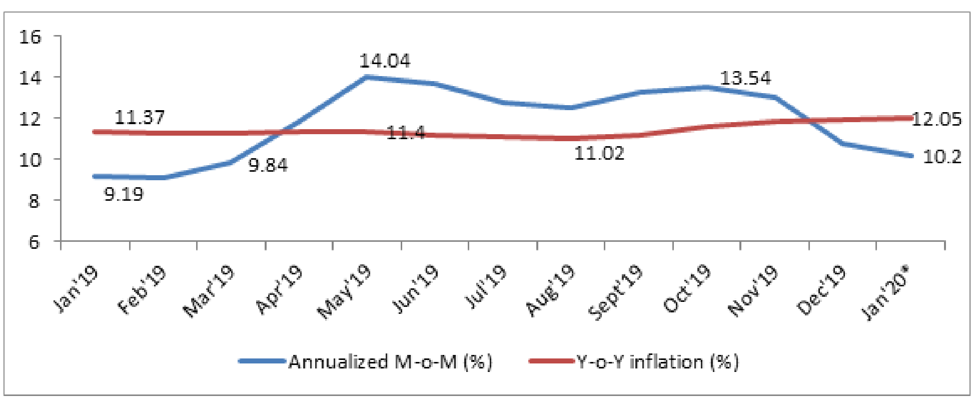
February 11, 2020

Inflation will cross the 12% threshold; pace of increase to slow significantly

Our market survey in January reveals that headline inflation is likely to inch up to 12.05% from 11.98% in December 2019. If this forecast is accurate, it will mean that inflation has increased for five consecutive months. This will be a major concern for the policy makers. The MPC, at its last meeting, emphasized the determination of the CBN to rein in inflation because of its negative impact on GDP growth and unemployment. We also expect food and core inflation to move in tandem with the headline inflation, rising to rise to 14.7% and 9.4% respectively.

The good news though is that the incremental change in the price level is now down to a mere 0.07% from 0.36% in October 2019. This is primarily because the base year effects of the border closure is losing steam and consumers' purchasing power is squeezed. The impact of the CBN's unorthodox policies has been a sharp decline in interest income, which has resulted in a reduction in aggregate consumption. The minimum wage impact has also been benign as Federal workers account for an insignificant proportion of the national workforce and some of the states are yet to commence payment. However, money supply growth and higher logistics cost continue to stoke inflationary pressures.

A further decomposition of the inflation survey shows a decline in the month-on-month inflation (which is more reflective of current prices) to 0.81% (annualized 10.20%). This confirms the notion that inflation may be approaching a point of tapering. This may indicate that recent policy measures are beginning to bear fruit and inflation expectations will get muted in the near term.



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[1]NBS, FDC Think Tank

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What factors are putting pressure on inflation?

Liquidity Surfeit

An increase in money supply causes inflation to rise as more money chases the same quantity of goods. In November 2019, money supply increased by 4.99% (5.44% annualized) to N28.42 trillion. This can be largely attributed to the CBN's heterodox policies in a bid to boost lending to the real sector. Credit to the private sector grew by 16.3% to N26.41trillion in November.

Lower output

Anecdotal and empirical evidence showed that economic activities slowed in January due to the post Christmas effect and the delay in the commencement of business operations. The 8.06% decline in FBN's purchasing managers index to 53.6 points in January from 58.3 points in December gives credence to the notion that January is typically a seasonally slow month.

Higher diesel prices

Diesel is the fuel that powers most distribution trucks and generators. A recent spike in the price of the product by 2.33% means that logistics costs will increase and further stoke inflationary pressures.

Inflationary pressures increased across SSA – 4 Reds, 3 Green

The food price inflation trend continues to determine the direction of inflation across sub-Saharan Africa (SSA). Three out of the six SSA countries under our review have released their January inflation numbers. While Kenya and Uganda recorded lower inflation rates, Zambia posted an increase.

In a surprise move, Kenya and South Africa cut their benchmark interest rates by 25bps at their respective meetings in January. Kenya attributed its rate cut to a well anchored inflation and dwindling inflation expectations while South Africa cited persistent economic vulnerability.

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Country	January Inflation (%)	January Policy rate (%)	Q3'19 GDP Growth rate (%)
Nigeria	12.05**	13.50 (Jan)	2.28
Angola	16.9 (Dec)	15.50 (Jan)	-0.80
Kenya	5.78	8.25 (Jan)	5.10
South Africa	4.00 (Dec)	6.25 (Jan)	0.10
Ghana	7.9 (Dec)	16.00 (Jan)	5.60
Uganda	3.40	9.00 (Dec)	2.70
Zambia	12.50	11.50 (Nov)	2.20

[2]

Inflation outlook in February

At the last MPC meeting, the committee increased the cash reserve ratio of banks by 500 basis points to 27.5% to curtail inflationary pressures in the economy. The mopping up of an additional N1.4trillion of total banking assets is expected to taper inflationary pressures. However, there are other inflation threatening factors which include:

- ***VAT hike***: The increase in VAT to 7.5% from 5% effective February 1 is expected to filter through to an increase in commodity prices, thus stoking inflationary pressures.
- ***Ban of motorcycles and tricycles***: The ban on tricycles and motorcycles in some parts of Lagos state has increased transport costs for some routes and led to increased demand on the available transport options. This will have a negative impact on productivity and ultimately output.
- ***Higher logistics and distribution costs***: Higher diesel prices would increase firms' logistics and distribution costs. Depending on the elasticity of demand of the product, the cost effect could be passed on to customers in form of higher commodity prices.
- ***Supply bottlenecks***: The lingering effect of the border closure and forex restrictions will continue to weigh on the general price level.

[2]Trading Economics, **FDC forecast