FDC Economic Bulletin

February 09, 2017

Headline Inflation to remain relatively flat at 18.6%

The FDC Think Tank estimates a relatively flat movement in the January headline inflation rate to 18.6% from 18.55% in December. Prices have generally either declined or remained flat recently. The percentage decline in 2017 was pale in comparison to 2016, leading to a marginal surge of 0.05%. The food basket especially has been relatively more inelastic than other commodities.

Movements in the consumer price index will be analyzed through a brief look at three key factors. These factors include seasonality effects, supply shocks and exchange rate pass through effects through export smuggling.

Seasonality effects

Christmas festive spending contributed to a surge in demand at the end of 2016, albeit marginal in magnitude when compared to previous years. As January approached the seasonal slur in economic activities and lower purchasing power (due to payment of tuition and post Christmas blues) kicked in. Hence, a paltry increase of 0.05% in the Year-on-Year rate in January.

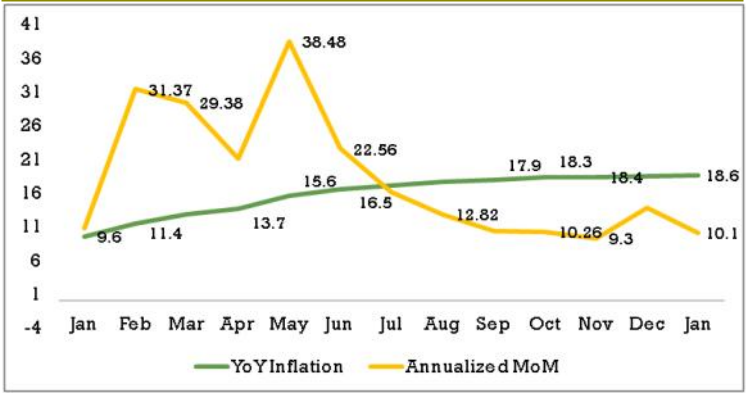
Supply shocks

Power supply, distribution and logistics costs were a major challenge for manufacturers. Diesel prices skyrocketed to an average of N270/ltr from N140/ltr in the same period the previous year. Power supply from the grid dropped sharply to 2500 MW in January leading to higher distribution and logistics costs. The Producer Purchasing index (PPI), the major ingredient of core inflation is likely to remain high.

Exchange rate pass-through leading to export smuggling

Exchange rate pass through was considered to have a one-way directional effect on prices. This means that a weaker naira makes imports expensive. The new phenomenon is that a weak naira makes domestic goods cheaper and increases the incentives for export smuggling.

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



Source : NBS, FDC Think Tank

Declining purchasing power squeezing demand

The impact of rising prices is felt in the value naira-based earnings and investments. Individuals are unable to afford the same quantity or brands of items to which they purchased at the same income level. The fact that there is no corresponding real wage inflation to counteract the effects of rising price inflation has birthed strong consumer resistance in the market.

This trend began to manifest itself last year as the pace of inflation began to slowly ease. However, albeit this revision of expectations, consumers are still unhappy about their present economic realities and have taken to the streets in protests against government policy and economic hardship.

Outlook: The rising importance of M1 scrutiny

The CBN has indicated that it would begin monitoring narrow money movements more closely, which has been a potent but silent contributor to inflationary pressures. The CBN, although silent on M1 numbers,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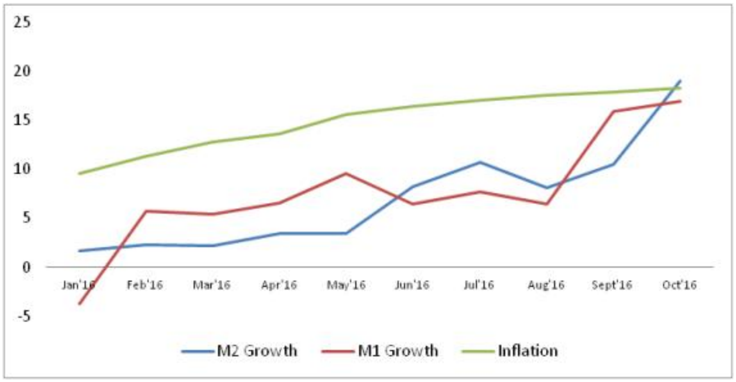
argued that most monetary aggregates grew beyond anticipated targets in 2016. Monetarists believe that the growth in narrow money (M1) corresponds with inflation and the graph below illustrates the correlation.

Chart 2: % Money Supply Growth



Source : NBS, FDC Think Tank

The most recent data on narrow money (M1) growth shows an increase to N10024 billion in October 2016 from N9949 billion in September of the same year. Therefore the expedient clamp down on the growth rate of M1 is of great importance. Therefore in its bid to execute this agenda the CBN might be backed into the corner in terms of its excessively generous grants to sectors like and not exclusively limited to the agricultural sector for example.