FDC Economic Bulletin

March 07, 2017

February Inflation likely to decline to 17.1%

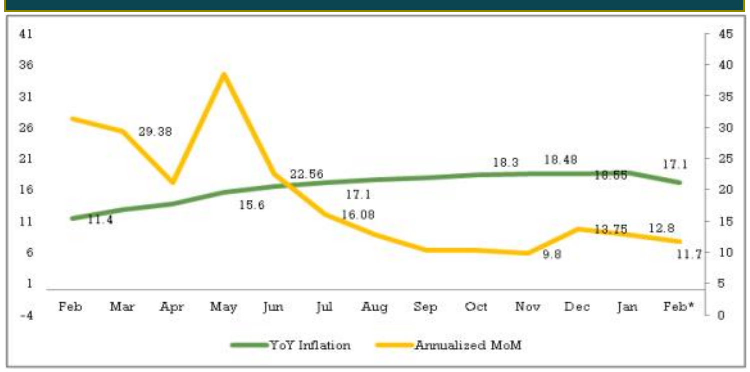
Headline inflation is almost certainly set to decline for the first time in 16 months when the NBS releases the numbers next week. This forecast is based on a regression model and empirical analysis. Most anecdotal proxies also seem to suggest that the trend of a slowing pace in inflation is consistent with the outcome of our regression.

Headline inflation spiked to 18.72% in January as a result of an unexpected jump in food inflation and the impact of record high diesel price at N275 per litre. In January, the core and monthly indexes declined contrary to the direction of headline inflation.

The fundamental reason for this decline is the impact of significant developments in February 2016 (base year effects). In February 2016, distortions in the forex market led to a significant jump in CPI, beginning a trend that lasted for several months. February 2017 has been relatively stable compared to last year; hence we expect a moderation in the increase in CPI from 4.18 in 2016 to 2.0 in 2017.

This means that a new trend of declining inflation is on the horizon. This new trend is observed amongst a number of Nigeria's sub-Saharan African peers like Angola and Malawi. It is noteworthy that the anticipated decline in the February numbers does not mean that prices will decline.

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



Source : NBS, FDC Think Tank

A decomposition of our CPI estimates results in a 0.9% (11.7%, annualized) month-on-month inflation rate. There were no dramatic events in February to differentiate consumer price movements in the month from

that of January. However, the end of February marked the beginning of what many believe is the path towards a more liberalized forex market.

The CBN announced far-reaching changes in the forex market with weekly disbursements of $1 million to DMBs at a price of not more than 20% mark up of the IFEM rate. The CBN also sold a significant amount of dollars in the forwards market. The actions of the 'born-again' CBN saw the naira appreciate by 15% in the first seven days. This fueled hopes that the pressure on consumer prices from forex policy inconsistency and market scarcity is on its way to a decline.

Possible Impact

The Monetary Policy Committee is to meet on March 20/21 to decide the course of monetary policy. It is expected that the GDP numbers, which were recently published, and the inflation rate will be major considerations at the meeting.

Fourth quarter 2016 GDP growth improved by almost 100bps to -1.3% from -2.24% in the previous quarter, while full year growth rate contracted to -1.51%. The improvement in GDP numbers and anticipated slowing in the inflation rate are likely to sway the committee towards taking up its agenda to pursue a more accommodative stance with respect to interest rates.

US Fed rate hike

The Fed is likely to raise rates upon the conclusion of its March 14 -15 deliberations. This is meant to be an anchor to the possible inflationary impacts of President Trump's expansionary policies, which may cause instability in prices. The impact of this is a stronger dollar and its inverse relationship with oil prices means that Nigerian oil revenues could be threatened.