FDC Economic Bulletin

April 07, 2017

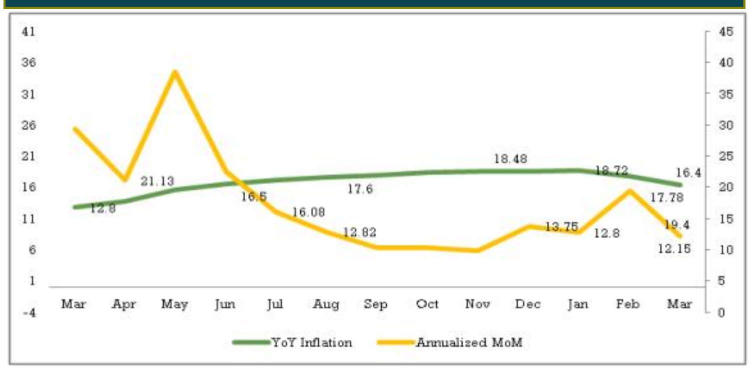
Headline Inflation will decline to 16.4%

We are forecasting that Headline inflation will decline for the second month running to 16.4%, as a result of further waning of the 2016 base year effects. The NBS is expected to release the inflation data next week. The reasons for a moderation in the price level in March are not farfetched. February/March 2017 was the period when the CBN's aggressive intervention in the forex market forced a major appreciation in the Naira (13.5% to N392) and has fed mildly into retail prices.

However, more significantly is the steep decline in the price of diesel from a peak of N260 to N195 at the wholesale level. Power also improved in the month with average output at the grid at 3773MW.

The 90-day transmission lag effect of the CBN's forex policy as well as manufacturer's inventory cycle may have delayed some of the pass-through effect of raw material and finished goods cost reduction. The full impact of these policies will become manifest in the months of April and May.

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



Source : NBS, FDC Think Tank

Month-on-month inflation

If our estimates are accurate, month-on-month inflation will decline by 0.53% to 0.96% (12.15% annualized). This decline will be consistent with the contraction in money supply and the velocity of circulation in the economy. Money supply (M2) contracted by 5.73% in February (-34.38% annualized) and this trend is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expected to persist in March. The number of POS transactions and NEFT also declined by 1.19% and 9.64% respectively in February.

A surge in money supply usually leads to an increase in the consumer price level. Therefore as a result of the CBN's intervention in the FX market, over N1trillion was effectively mopped up to fund dollar transactions and thus resulting in a contraction in system-wide liquidity.

Global inflationary trends

In some advanced economies, we are beginning to see a wave of creeping inflation for example US inflation crossed the Fed target of 2% to spike to 2.1%, the first time in 5 years. This has prompted market analysts to believe that there will be at least two Fed rate hikes to compensate for the Trump administration's expansionary policies. This makes dollar-based instruments more lucrative as investment tools, shifting investment from emerging markets such as Nigeria to the US.

Similarly, CPI rose in the UK by 2.3% from 1.8% in January, the steepest monthly increase since 2012. This is attributed to rising imported inflation following the depreciation of the pound.

Outlook

The demand for forex in the Nigerian economy is a combination of actual and speculative demand. Therefore, irrespective of the level of CBN intervention in the market, inflation expectations are likely to drive future price movements. Market players are increasingly cautious in factoring possible naira appreciations into their expectations and with good reason, as the naira is currently trading lower at N405; in spite of aggressive CBN intervention. Therefore, coupled with further erosion in base year effects, the CBN's ability to establish a sustainable forex policy will help shape inflation expectations for the future.