FDC Economic Bulletin

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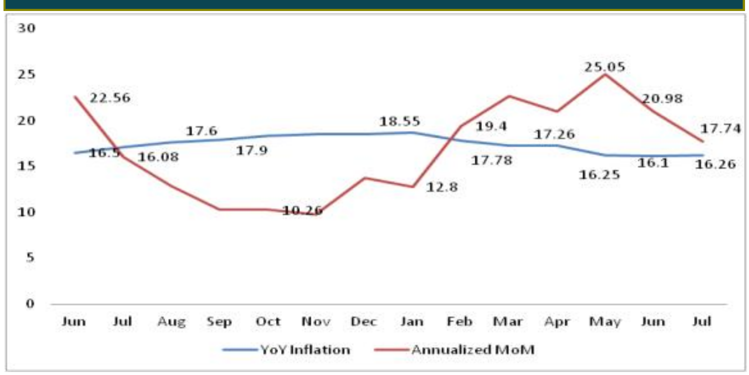
Headline Inflation in July to marginally increase to 16.26%

Year-on-Year headline inflation is expected to increase by 0.16% to 16.26% in July, leading to a reversal of a positive trend of the last 5 months. The influence of base year effects on headline inflation has weakened immensely.

In our estimates, month-on-month inflation is expected to taper significantly to 1.37% (17.74% annualized) from 1.6% (20.98% annualized) in June. This reduction in the monthly inflation is a manifestation of further exchange rate appreciation as the naira has been relatively stable in the forex market. PMI, a proxy for manufacturing activity, improved further to 54.1 in July, signaling an expansion in manufacturing activities though supply-side constraints persist. Manufacturers are building up inventory levels on the perceived idea that the economy is improving. Unfortunately this is occurring in an environment with naira illiquidity, large carrying costs and dwindling disposable income. The rains and flood in July disrupted movement and reduced traffic to supermarkets. Power supply dropped below 3000mW/hr in July.

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



Source : NBS, FDC Think Tank

There was a general moderation in food prices even though there were a few outliers such as beans and rice. The decline in power supply from the grid during the period resulted in higher electricity costs, while the price of diesel, which is generally used to power generators and trucks increased by 6.25% to N170 per litre.

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Outlook

Consumer prices are to be directly affected by the beginning of the harvest season. Competitive pressures amongst manufacturers and retailers have intensified and are anticipated to fuel further price decline of some manufactured goods.

There are some other factors that have an impact on prices, which include the trend of increased capital importation by foreign investors. These investors are buying naira denominated assets and their foreign exchange is helping further injections by the CBN. However, the country is prone to a stock market and forex market shock as many analysts believe that gains in both markets are bubbles.

In the event that these two outcomes materialize, the economy might stumble and consumer prices are likely to shoot up on output constraints.

Consequences

If the inflation numbers change direction as anticipated, the hawks at the MPC will again be emboldened to maintain the current stance. We are thus likely to see the status quo maintained.