

FDC Economic Bulletin

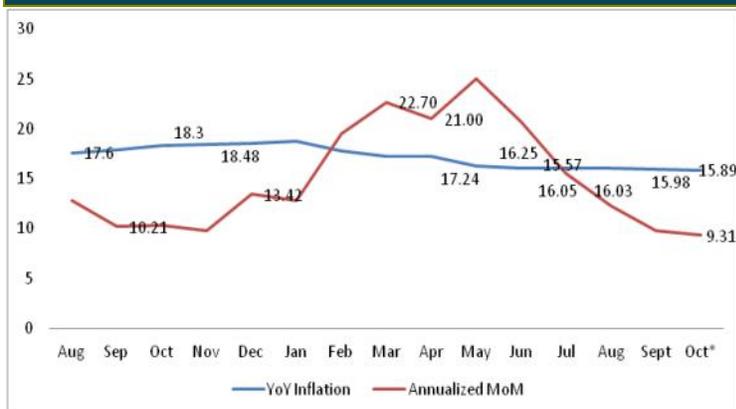
November 08, 2017

Headline inflation to decline again to 15.89% in October

We are forecasting that Nigeria's year-on-year headline inflation will slide to 15.89% in October. This is a marginal decline of 0.09% from September's rate of 15.98%. Whilst the scale of change is marginal, the downward direction of movement is important to policy makers. If our estimates are accurate, this will mark the ninth consecutive monthly decline in the year 2017. We also expect month-on-month inflation to moderate to 0.74% (9.31% annualized) from 0.78% (9.84% annualized) in September.

A continuing trend of slowing inflation will be music to the ears of the economic management team, who have insisted that the economy is beginning to recover from its sharpest downturn in decades.

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



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Food inflation also decreases

This reduction in inflation can be mostly attributed to the slide in food prices, especially grains, and to a lesser degree in the slight appreciation of the naira to N363/\$ in October. Also interesting is the ample liquidity in the forex market which helped ameliorate forex shortages.

¹ Source: NBS, FDC Think Tank

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Food inflation, which has been the major driver of year-on-year headline inflation so far this year, is expected to decline to 20.1% in October from 20.3% in September. Domestic food inflation is benefiting from a bountiful harvest and prices are beginning to reflect in the food basket. Major food items such as flour, yam, garri, rice and tomatoes recorded price drops partly due to the intensity of competition, putting downward pressure on the food basket. The increase in output during the month was complemented by the move by manufacturers to exhaust existing inventory and restock for the festive season. This somewhat offset the inflationary pressure from high logistics cost.

Core inflation is expected to rise marginally to 12.2% in October from 12.1% in September as high logistics cost still plagues the economy. Diesel prices rose to N205/litre during the month of October even though there was some improvement in power supply in October – increasing to 3,696MW/hr.

Rural inflation dips further

We also expect a significant decline in rural inflation relative to urban inflation, as information asymmetry in the urban region restricted the impact of falling food prices during the month of October.

The CBN has continued in its use of OMO auctions and other intervention tools to control money supply, which affected the opening position of banks. The mopping up of excess liquidity saw average rates spike to 32% in October from 19% in the previous month. This raises doubts the willingness of the CBN to embrace a flexible policy.

Outlook

The proposed 2018 budget released makes rather optimistic assumptions about headline inflation. It assumes a decline in the average inflation rate to 12.4%. This is in doubt as pre-election spending in addition to increased forex demand is likely to trigger inflationary pressure.

We expect that headline inflation would bottom out in October. This is because consumer prices typically rise as aggregate demand for goods and services increase as the festive season kicks off.

The MPC is scheduled to hold its last meeting for the year on November 20/21. This will be the last meeting for four members of the committee. Most members would refrain from a review of current rates and maintain status quo in the interim, as output levels gradually increase.

However, we believe the committee will eventually succumb to political pressure, as lower interest rates will cut the cost of credit and give some support to the government's economic recovery efforts.

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