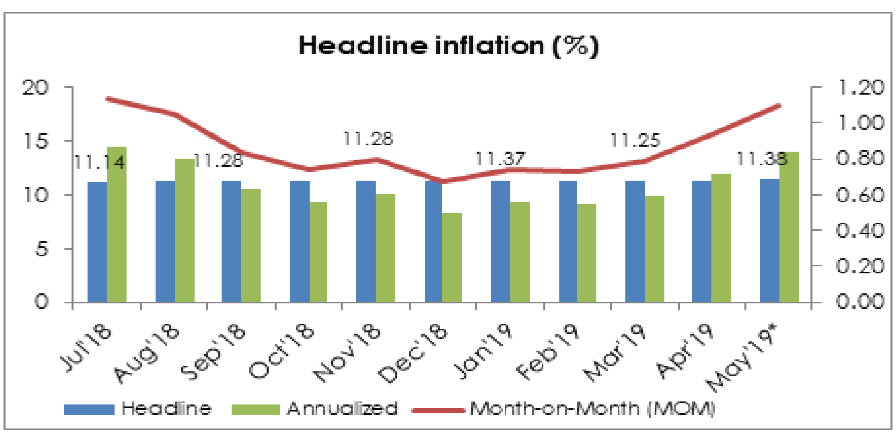
Headline inflation to inch up to 11.38%

We are projecting that the headline inflation would inch up to 11.38% in the month of May from 11.37% in April. If our forecast is accurate, it will be the second monthly rise in 2019. The increase in the annual inflation rate is likely to be driven by seasonal shortages due to the planting period. During our survey in the month of May, we noticed a mixed trend in commodity prices. Whilst the price of tomatoes, pepper and yam increased due to planting season, the price of rice and melon declined whereas garri was flat. The money supply impact was muted as M2 growth (annualized at 5.54%) remains below the CBN's target of 12.99% in 2019. Even though the average opening position of the banking system increased to N289.48bn, the CBN's aggressive liquidity mop-up through OMO activities subdued its impact. OMO bills issued increased by 114.6% to N1.13trn.

We also expect the month-on-month inflation (a better reflection of current prices and inflation expectations) to move in tandem with the headline inflation, increasing by 0.16% to 1.1% (14.04% annualized) in the month of May. This will be the fourth consecutive monthly increase and the highest rise in the monthly general price level in 2019. Even though the uptick in the headline inflation is expected to be marginal, rising monthly inflation suggests heightened inflationary pressures.

Core inflation (inflation less seasonalities) is expected to decline marginally to 9.2% in the month of May from 9.3% in April. This would be driven by the relative stability in the exchange rate. The naira was stable within the range of N360/$ - N361/$ at the parallel market.



[1]

[1]NBS, FDC Think Tank

Some inflation-inducing factors noticeable in the month include:

- ***Money Supply Growth Supported by a Boost in Liquidity***

Money supply growth is a major factor that drives inflation. Broad money supply growth has been muted in the last few months. The CBN's target for M2 is 12.99% whilst the actual growth was 5.54% annualized. The CBN has been extra sensitive to the impact of M2 and high powered money on the general price level. It has therefore resorted to aggressive OMO activities to mop up liquidity. Hence, even though the average opening position of the banking system had increased to N289.48bn, the OMO bills issued increased to N1.13trn. The MPC has expressed concerns about the level of government securities held by banks and its effects in constraining lending. It is therefore possible that we may see new guidelines in this respect shortly. The impact of the new policy will be a reduction in earning options of banks and a possible increase in market debts (CPs and bonds).

- ***PMI recorded its sharpest fall in two months***

The Purchasing Manager Index (PMI), which measures the health of the manufacturing sector, declined by 10.39% to 50.9 points in the month of May. All the sub-indices with the exception of employment declined. The sharpest fall was recorded by the output sub-index which moved into the contraction region. The Index fell to 49 points in the month of May from 58.5 points in the previous month. Output growth was constrained by lack of access to affordable credit by manufacturers amid softer demand due to the Ramadan fast. The sharp decline in output would weigh on commodity prices, thus signaling heightened inflationary pressures in subsequent months.

- ***Diesel prices remain sticky downwards***

The average national price of diesel increased by 0.66% to N230.67/liter in April. In the month of May, diesel prices remained stubbornly high at N230-N240 per litre in Lagos. This is expected to increase logistics and distribution costs. Depending on the price elasticity of demand for the commodities, manufacturers are likely to pass on these costs to consumers through higher prices. An increase in price would weigh on inflation in subsequent months.

Lending to be accompanied with increased labour productivity to taper inflation

At the last MPC meeting, the committee noted that the economy has a spare capacity for non-inflationary

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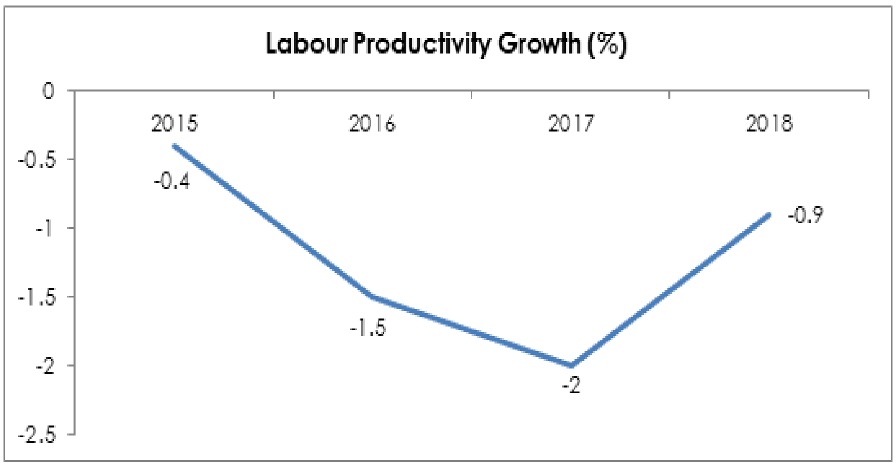
Web: www.ubagroup.com Email: cfc@ubagroup.com *Africa's global bank* growth as actual output is still below the country's potential capacity (a recessionary gap), thus suggesting the need for a boost in credit to the private sector (CPS). Although, credit to the private sector grew by 9.64% in April, it has remained below the provisional benchmark of 12.39% since the beginning of the year. An increase in CPS is positive for investments. According to Rencap, Nigeria needs to increase its investment-to-GDP to 25% (currently at 14%) to achieve sustainable growth. Growth is also a function of productivity. Labour productivity has been negative in the last four years (currently -0.9%). A higher minimum wage without a corresponding increase in labour productivity could be inflationary.



[2]

Peer Comparison – 4 greens, 3 reds

Inflation trends in Sub-Saharan Africa (SSA) have moved in mixed directions since the beginning of the year. Three of the SSA countries under our review released their inflation numbers in the month of May. While inflationary pressures are mounting in Zambia, Kenya and Uganda recorded declines. For the month of April, Angola and South Africa recorded a decline while Ghana posted an increase.

At the last MPC meeting, most of the SSA countries under our review left their monetary policy rate unchanged.

Country	May Inflation (%)		MPR (%)	
Nigeria	11.38**	↑	13.5	↔
Angola	17.36*	↓	15.5	↓
Kenya	5.49	↓	9.0	↔
South Africa	4.4*	↓	6.75	↔
Ghana	9.5*	↑	16	↔
Uganda	3.3	↓	10.0	↔
Zambia	8.1	↑	10.25	↑

[3]

[2] EIU, FDC Think Tank
[3] Trading Economics, FDC Think Tank; *April inflation rate; **May inflation forecast

Concluding Thoughts

We expect inflationary pressures to intensify in June as the planting season effect lingers. This could be further heightened by the minimum wage impact, increased forex demand for summer and Hajj. The monetary authority, which is saddled with the responsibility of maintaining price and exchange rate stability, is more likely to be hawkish in its policy decisions.

However, the committee, being cautious of the slow economic recovery, could leave its monetary policy parameters unchanged but likely to continue with its aggressive liquidity mop-up through OMO activities.