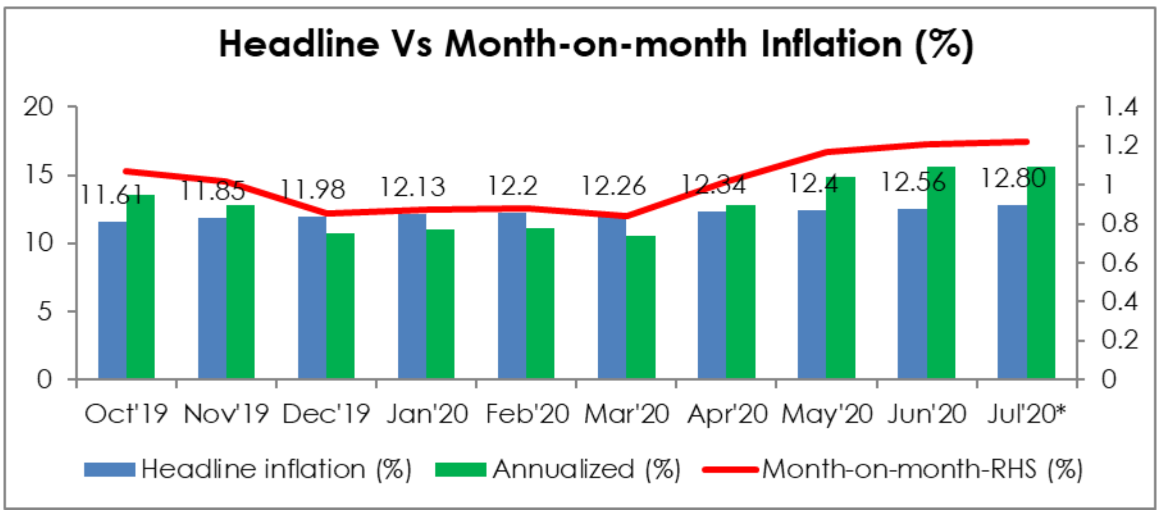
FDC Economic Bulletin

August 13, 2020

Headline inflation fast approaching the 13.0% threshold due to cost push factors

Our recent market survey reveals a further build-up in inflationary pressures as supply chain disruption continues to take its toll on prices. This is in addition to the limited exchange rate pass through to the market. Manufacturers are scratching their heads on how to get dollars not to talk of the rate of exchange if and when it is available. The forex uncertainty and the supply bottlenecks together with an increase in the price of PMS are culminating in a potential jump in the headline and food inflation to 12.8-13% in the days ahead. The price increase is not a Nigeria-specific feature as most peer countries are also reeling from a gradual climb in prices. The EIU is forecasting that SSA inflation will increase from 7.9% in 2019 to 8.4% in 2020.



[1]

Gradual Shift towards general equilibrium

The move towards reducing or eliminating subsidies, the adjustment effect of the exchange rate convergence and the adoption of cost reflective electricity tariffs point to a gradual shift from static to partial and eventually general equilibrium. The CBN has adjusted the exchange rate twice in the last six months to N381/$ at the official window. The EIU is also projecting another adjustment to N420/$ by the end of 2020 and N450/$ by the end of 2021. This is in line with the government's effort in unifying the

[1]NBS, FDC Think Tank

multiple exchange rates as part of its COVID-induced Economic Sustainability Plan. The eventual swing towards a general equilibrium will reduce speculations and eliminate market distortions.

Harvest season sub-optimal to suppress inflationary pressures

The harvest season, which typically commences in the third quarter, is expected to taper inflationary pressures. This is because output usually increases during this period. However, the 6 months closure of the Third Mainland Bridge amongst other structural constraints such as higher logistics costs could disrupt commodity supply. This will limit the impact of the harvest in tapering inflationary pressures. According to a recent report by the Lagos Business School, 1,600 of 25MT, 5,060 of 8MT and 13,500 of 3MT trucks bring foodstuff into Lagos state on a daily basis. This is likely to push urban inflation higher to 13.25%.

Weighting or reconstructing the composition of the consumer basket: A necessary evil

The COVID-19 pandemic has disrupted both the global and domestic economy, causing a shift in consumer spending pattern. The squeeze in consumer disposable income due to the COVID-induced economic paralysis and the social distancing rule has compelled consumers to shift their spending pattern in favour of necessities such as food and internet services. However, this change is yet to reflect in the weights and composition of the CPI basket. It is advisable that a country reviews the weight and composition of its Consumer Price Index (CPI) basket periodically (5 years interval). In fact, most advanced economies revise their consumer basket on an annual basis. In Nigeria, the last time the basket constituents were reviewed was in 2009. This will lead to a significant bias in the measure of inflation and ultimately affect policy decision making. To eliminate this bias, it is important that the CPI basket is revised to reflect current market and economic realities.

Inflation Breakdown

Month-on-month inflation to climb to 15.71% annualized

Similar to the annual price level, month-on-month inflation is expected to increase again to 1.22% (15.71% annualized) in July from 1.21% (15.58% annualized) in June. Even though the direction of the inflation curve is to the upside, the marginal increase in the inflation rate could suggest that the harvest season is slowly cushioning the effect of the cost-push factors.

Food inflation to inch-up in spite of the harvest

Food inflation is expected to continue its rising trend, albeit at a slower pace of 0.02% to 15.20%. This is because of the impact of the prevailing supply chain disruptions, Third Mainland Bridge closure and PMS price hike. This will further reduce consumer purchasing power and lower aggregate demand. However, the harvest season could slowdown the pace of increase in food inflation rate.

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Weaker naira and rising import bill to push up core inflation

The depreciation of the naira and its resultant impact on imported inflation will continue to impact on core sub-index (headline inflation less seasonalities). In the last seven months, the naira has lost approximately 23.79% at the parallel market while commodity prices have increased by over 100% in the last six months. In addition, the price of fuel has ranged from as low as N125/litre to N147.50/liter. Higher PMS pump price will increase transport costs, which will most likely be passed on to the final consumer. Therefore, we are projecting a 0.05% increase in the core inflation to 10.18% in July.

Peer Comparison – Mixed movement in Inflation – 5 Reds, 2 Greens

Of the seven African countries under our review, only Nigeria and South Africa are yet to release their July inflation. Food inflation was the main driver of inflationary pressures for Ghana, while core inflation was the underlying factor in Angola, Uganda and Zambia. This is because of the currency weakness experienced in these countries. Kenya however recorded a dip in its inflation rate due to an ease in its food index.

However most African countries recorded a slowdown in their GDP growth rate with the exception of South Africa that was already in a recession prior to the pandemic. Q2 GDP numbers will be worse being the peak of the economic contraction and disruption in food supply. This has prompted the adoption of accommodative monetary policy stance by most of the countries, with average rate cuts of at least 50bps to 100bps and the disbursement of stimulus packages to boost output. However, it appears the cycle of rate cuts may be over for African economies who are battling the twin shock of rising inflation and currency weakness. The potent threat of these factors may outweigh the goal of stimulating the economy from a recession.

Country	July Inflation (%)		July Policy Rate (%)		Q1'20 GDP Growth (%)	
Nigeria	12.80*	⬆	12.50	⬌	1.87	⬇
Angola	22.93	⬆	15.50	⬌	-1.80	⬇
Kenya	4.36	⬇	7.00	⬌	4.90	⬇
South Africa	2.20 (June)	⬆	3.50	⬇	-0.10	⬆
Ghana	11.40	⬆	14.50	⬌	4.90	⬇
Uganda	4.70	⬆	7.00 (June)	⬇	1.80	⬇
Zambia	15.8	⬇	9.25[2] (May)	⬇	0.20 (Q'4 19)	⬇

Concluding Thoughts

The next MPC meeting is scheduled to hold on September 21. We expect the release of some key data points such Q2 GDP growth, unemployment and inflation before then, and these will partly influence the decision making process of the committee.

[2]Trading Economics, FDC Think Tank

Inflationary pressures are intensifying especially with the 20.4% increase in PMS pump price which may even increase further. In addition, the widely talked about cost reflective electricity tariffs may be implemented sooner than expected. However, consumer disposable income is being eroded gradually and with a budget constraint, the rational consumer will be forced to adjust spending patterns and ultimately reduce demand. This will limit to an extent the pace of increase in consumer prices.