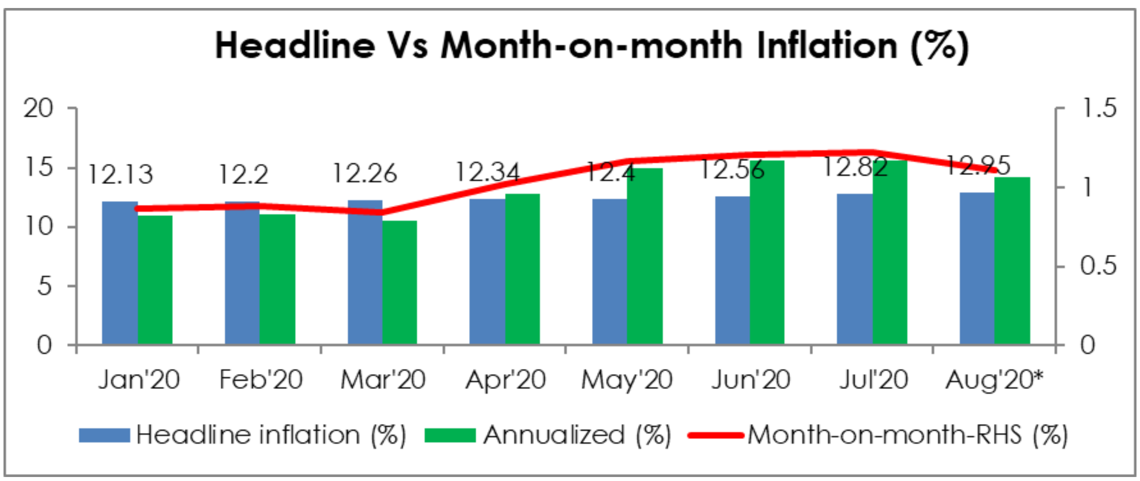
FDC Economic Bulletin

September 09, 2020

Headline inflation to creep up to 12.95%

Money supply growth and an astronomical increase (1.86%) in the value of transactions settled through the electronic payments systems in Nigeria could be part of the factors precipitating higher price inflation as forecast in our August projections. Total value of transactions jumped from N16.1trn in July to N16.4trn in August. The FDC survey suggests a likely increase in headline inflation to 12.95%. This represents a 0.13% creep up in the price level and will be a 30-month peak. More noteworthy is the fact that the pace of increase has slowed significantly and could be approaching a point of inflection.

The spike in the total value of transactions settled electronically is likely to increase the velocity of money in circulation. This coinciding with a contraction in GDP (-6.1%) could be a contributing factor to rising inflation. Other factors that could compound this include supply chain disruptions, higher logistics costs and currency pressures. However, as more companies and businesses re-open, aggregate supply is expected to increase. This coupled with squeezed consumer disposable income could reduce the rate of increase in inflation. According to the NBS Covid monitoring report for July, employment levels have increased to 81% of pre-COVID level with the biggest increase recorded in the Agric sector.



[1]

Annualized month-on-month inflation likely to decline by 1.69% to 14.23%

The good news is that month-on-month inflation, which is a more accurate measure of price movement, is projected to decline marginally to 1.1% (14.23% annualized) from 1.24% (15.92% annualized) in July. This will be the first decline in the last six months, reflecting the impact of the harvest season. Although, output

[1]NBS, FDC Think Tank

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remains below levels recorded in August 2019. This is largely due to flooding in some of the food producing states. According to Bloomberg, more than 25% of Nigeria's rice harvest was eroded by floods. All other inflation sub-indices are expected to move in the same direction with the headline inflation.

Year-on-year food inflation to inch-up to 15.56%, month-on-month to decline to 1.48%

The food basket, which is both exchange rate sensitive and seasonal, has increased steadily in the last 11 months. This is primarily as a result of the planting season, supply chain disruptions and exchange rate volatility. On an annual basis, we expect the food sub-index to increase at a slower pace to 15.56% in August from 15.48% in July. However, on a monthly basis, it is expected to decline by 0.04% to 1.48%. The slowdown will be largely driven by the harvest season and reduced consumer purchasing power. The food basket is also responsive to the price of diesel, a major factor in distribution and logistics costs. The diesel price fell by 5% to N190/liter in August from N200/liter in July.

SSA regional trend – mixed movement in inflation

The EIU projects a 0.5% increase in the average inflation rate across SSA in 2020 (8.4%). Data released so far in August shows that inflation is trending downwards in the region. While inflation declined in Uganda and Zambia, it remained flat in Kenya. Most policy makers left their monetary policy rates unchanged at their last meeting and are probably waiting to see the direction of oil prices.

Outlook

Some recent policy pronouncements that will likely affect inflation figures in September include:

Lower savings rate - The CBN has reduced the minimum interest rate on savings to 10% pa of MPR from 30% pa effective September 1. This means that at the current MPR (12.5% p.a), the savings interest rate floor is down 250bps to 1.25% pa from 3.75% pa in previous months. Savings accounted for 23% of total deposits in 2019, up from 14% in 2013. Lower interest rates at a time of rising inflation will further widen the negative real rate of return on savings to -11.57% from -8.38% in January 2020. This is likely to discourage savings and increase the marginal propensity to consume (MPC), which could heighten inflationary pressures.

Higher PMS price and electricity tariff hike - The move towards a market determined PMS price and the adoption of cost reflective electricity tariffs point to a gradual shift towards general equilibrium. However, it will have attendant consequences on cost of living. In August, Brent price was up 4.16% to an average of $45.02pb, resulting in a 7.67% increase in the pump price of PMS to N160/liter. This coupled with the cost reflective electricity tariffs would increase cost of living and could stoke inflationary pressures especially in the short-term. We however expect the cost reflective electricity tariffs to spur investment in the power sector and improve power supply in the long term. This will boost total factor productivity which has been negative (-0.7%) in the last five years.

Policy impact

In spite of the rising inflation trend, the most likely outcome considering the impact of economic contraction and high unemployment is to leave all monetary parameters unchanged at the next MPC meeting (September 21). The committee will continue to monitor the impact of recent policies such as the reduction in interest rates, on banking system liquidity and deposits.