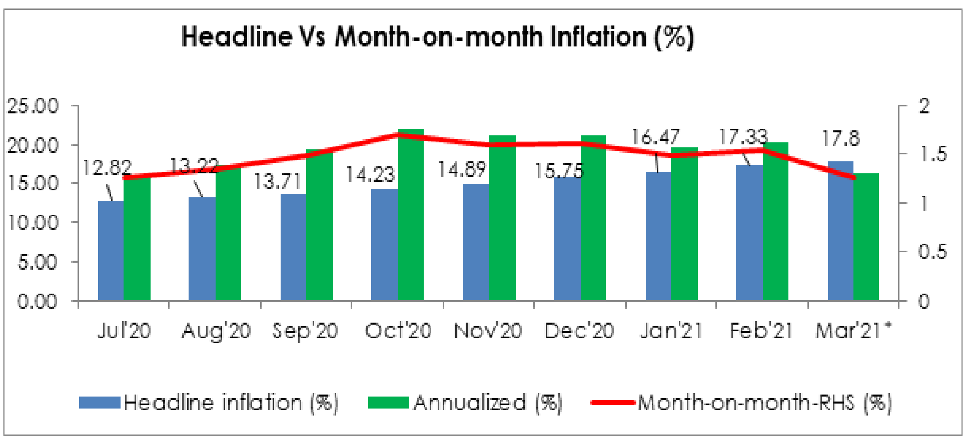
FDC Economic Bulletin

April 08 2021

Headline inflation to surge again towards 17.8%

The Nigerian Bureau of Statistics (NBS) will release the inflation figures for the month of March on April 15. Our time series model is forecasting a 0.47% jump in headline inflation to 17.8% (±0.2%). This will be the 19th consecutive monthly increase and a 48-month high. Exchange rate pressures have proven to be one of the principal inflation drivers in Nigeria. Manufacturers are currently experiencing difficulties in securing imported raw materials as forex rationing continues to take its toll. This pushed up import costs and reduced output, evidenced by the 3.02% drop in FBN PMI to 51.4pts in March. The decline in imported raw materials is forcing manufacturers to look inwards for local substitutes, reducing the supply of commodities to retail markets. Aggregate domestic output has been constrained by disruptions, low productivity (-0.5%) and logistics constraints. The FGN's borrowings (ways and means advances) have also increased money supply, exacerbating inflationary pressures.



[1]

Rising food inflation — Nigeria not alone

Our analysis reveals that both the food and core sub-indices are likely to increase in the month of March. Food inflation is projected to rise to 22.3% while core sub-index could climb to 12.6%. Notably, rising food inflation is not a Nigeria-specific phenomenon. According to the Food and Agriculture Organization, the Global Food Price Index rose by 2.1% to 118.5pts in March. This was driven by strong demand for basic food stuffs such as vegetable oils, meat and dairy.

[1] NBS, FDC Think Tank

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Month-on-month inflation to drop on weak consumer demand

Month-on-month inflation, which has oscillated in the last three months, is projected to decline to 1.26% (16.17% annualized) in March from 1.54% (20.22% annualized) in February. Weak aggregate demand and consumer resistance to price increases have forced most manufacturers to bear the burden of higher production costs. This is unlikely to be sustained in the coming month as expenses continue to climb, squeezing corporate margins. Also, brand loyalty is being tested as commodity prices increase, forcing consumers especially at the bottom of the income pyramid to shift to relatively cheaper commodities.

Monetary conditions and monetary policy

The sharp increase in headline inflation is likely to force the CBN to reconsider resuming its tightening cycle. Typically, monetary conditions and monetary policy move in opposite directions to keep the price level under control. When monetary conditions are loose, the CBN adopts a tight monetary policy stance to ensure price stability and vice versa.

With inflation spiralling and currently double the upper band of the CBN's inflation target (9%), a likely increase in interest rates is not only imminent but almost inevitable. The good news is that policy makers are becoming increasingly aware of the need to increase interest rates before inflation spirals out of control. A third of the committee members (MPC) voted for a rate hike at the MPC meeting in March. This is likely to increase towards a majority of members in the month of May.

Rising interest rates to reduce the negative real rate of return

It appears the CBN is using its ordothox policy tools to change the interest rate direction. Yields on the 364-day T/bills tenor increased to 8.0% from 2.0% in January while OMO bills of the same tenor are now slightly above 10%. With interest rates rapidly increasing, the negative rate of return on investment will reduce.

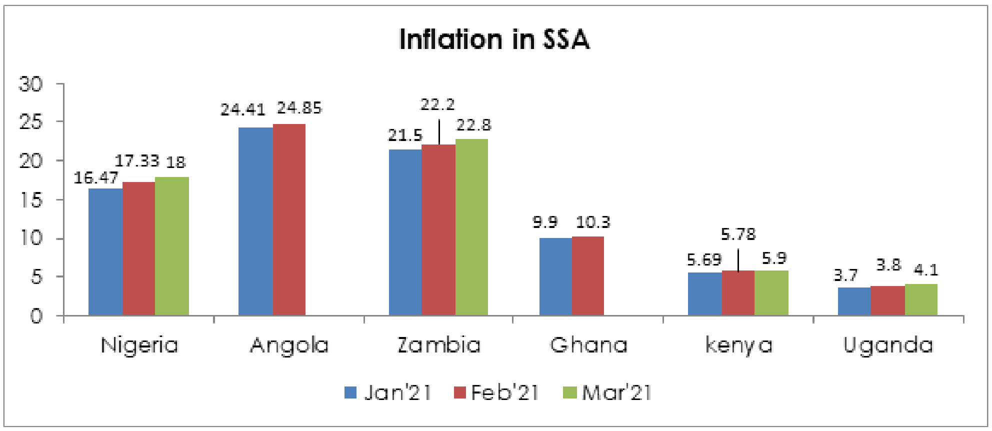
[2]

[2] NBS, CBN, FDC Think Tank

Regional inflation more to the upside

Regional inflationary trends have been increasing since the beginning of the year. This can be largely attributed to higher food prices, weaker currencies, higher energy costs and rising housing and utilities expenses. According to the EIU, SSA inflation is projected to average 8.1% in 2021 before edging down to 8.0% in 2022.

The regional central banks are beginning to take steps in taming rising inflation. Zambia's MPC raised its benchmark interest rate by 50 basis points to 8.5% during its February meeting. Nigeria is likely to follow suit in Q2 as inflation continues its upward trajectory.



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What to expect in Q2'21

Headline inflation is expected to continue its upward trend in Q2 as the planting season commences, further exacerbating pricing pressures. The CBN might be forced to adopt a tighter monetary policy stance to curb rising inflation and ensure macroeconomic stability.

[3] Trading Economics, FDC Think Tank