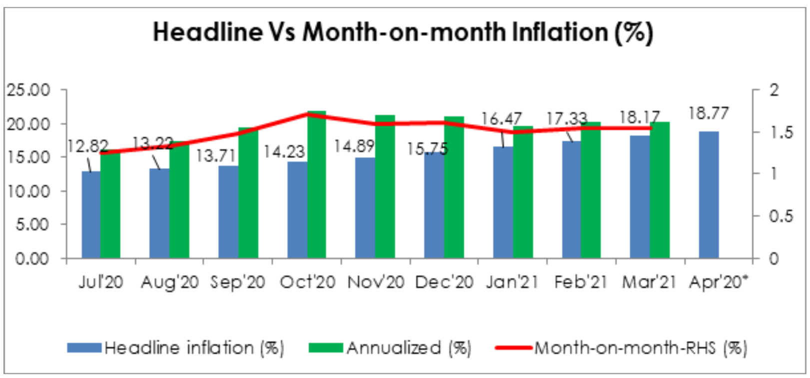
FDC Economic Bulletin

May 05, 2021

April headline inflation to reach 18.77%

Nigeria's inflation has consistently defied the law of gravity - 'what goes up must come down'. In April, we are estimating a further increase of 0.6% to 18.77%, after 19 months of consecutive increases. The debate on whether consumer price inflation is transient or persistent has been raging for months. Many economists argue that inflation cannot be persistent in an economy that is operating below the natural rate of employment. While some policy makers have attributed the current surge in inflation to output shocks and supply chain disruptions due to insecurity, others are of the opinion that inflation in Nigeria is transient and largely driven by money supply saturation. We are of the view that when economic variables are transient for an extended period, it becomes persistent.



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Insecurity - A cause or effect of high inflation?

Economists attribute heightened insecurity to rising poverty and misery levels. In Nigeria, the misery index, which is the summation of inflation and unemployment rates, increased to 51.47% from 34.54% in 2018.

However, analysts have attributed the current spike in inflation to heightened insecurity due to supply chain disruptions. There has been a surge in the rate of kidnappings, banditry and hijacks, which is fast spreading to the South West and South East. The raises the question of whether a casual relationship exists between inflation and insecurity. The states with the highest inflation rates are predominantly in the North East, North West and North Central - Kogi (24.51%), Bauchi (22.24%) and Sokoto (20.7%).

[1] NBS, FDC Think Tank

In the last few months, some analysts focused more on the impact of high powered money and FG borrowing from the CBN while others blame high inflation on the pass through effect of exchange rate on domestic prices. If insecurity challenges linger, Nigeria risks another major food crisis especially at a time when the country faces forex challenges. Food inflation is estimated to increase to 24% in April.

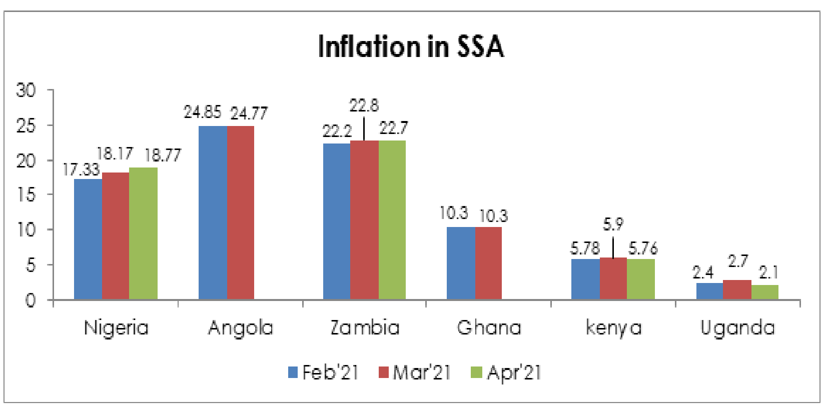
Month-on-month inflation to fall slightly on weak aggregate demand

All inflation sub-indices except for the month-on-month index are expected to follow a similar trend with the headline inflation. The monthly consumer price level is projected to slide by 0.03% to 1.53% (19.95% annualized) in April from 1.56% (20.40% annualized) in March. This is largely due to weak aggregate demand, resulting from reduced consumer disposable income.

Is the recent drop in SSA inflation sustainable?

Nigeria's inflation has consistently remained above the SSA average in the last five years. The country has the 7th highest inflation rate in Africa. It appears that the inflation trend across SSA region is beginning to decline. Three of the countries under our review reported lower inflation rates in April, partly due to a stronger currency and lower food prices. While the EIU expects inflation within the SSA region to fall to an average of 8.1% in 2021, Nigeria's inflation is expected to witness an upward trend before tapering slightly towards the end of the year due to the harvest season and increased forex supply.

Of the SSA countries under our review, only Zambia has increased its benchmark interest rate so far in 2021. It increased its policy rate by 50bps to 8.5%p.a at its February meeting to curb rising inflation. Nigeria could be forced to increase its monetary policy rate in Q2 as inflation continues to rise. This could however be constrained if the GDP numbers come out worse than expected.



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[2] Trading Economics, FDC Think Tank

Impact on policy makers

In spite of the commodity super cycle and gradual economic recovery, most Central Banks have left their monetary policy rates unchanged. The US Fed, at its last meeting left its benchmark interest rates close to near zero (0-0.25%p.a) despite acknowledging that the US economy is accelerating and inflation is rising.

However, Nigeria might not have the luxury to leave its monetary policy stance unchanged for long. With inflation rising faster than expected, the MPC could lean towards the resumption of a tightening cycle by increasing the MPR by 25bps as a way of protecting the value of the naira in the forex market amongst other measures.