FDC Economic Bulletin

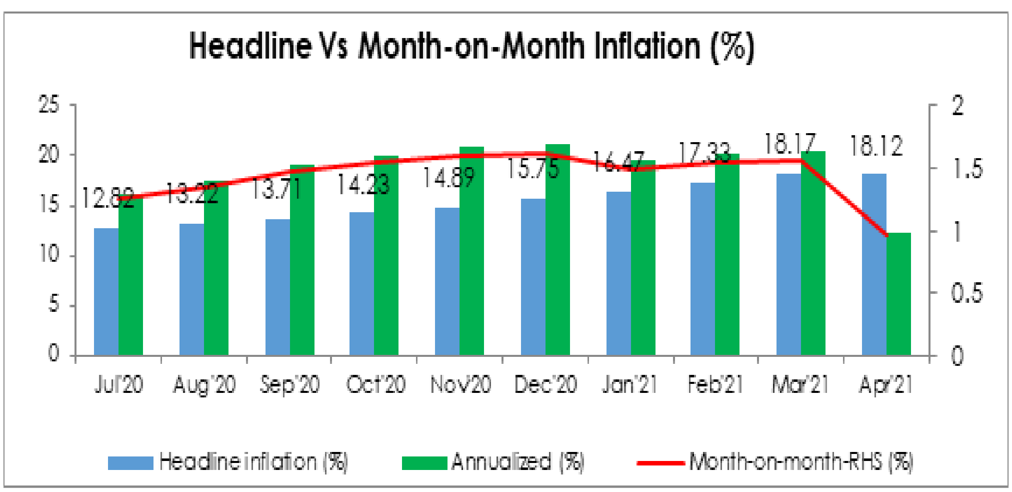
May 18, 2021

Headline inflation slips to 18.12% in April: A blip or a trend?

Surprisingly, Nigeria's headline inflation for April fell slightly by 0.05% to 18.12% from 18.17% in March. This is the first decline since August 2019 when the land borders were closed. The unexpected drop in the annual price level can be partly attributed to the decline in the food sub-index. Food inflation moderated to 22.72% from 22.95% in March.

Consensus view of Economists compiled by Bloomberg forecast is an inflation rate of 18.8%. The variance between forecasts and the published data can be explained by inflation expectations and the possible underestimation of consumer resistance to price increases. Most analyst expectations were anchored on the view that the major causes of inflation remain entrenched.

It is worth mentioning that a decline in inflation does not necessarily imply that prices are falling. It simply means that commodity prices are increasing albeit at a slower pace. Of all the inflation sub-indices, only core inflation increased. All non-food items increased particularly healthcare (15.88%) and transport (14.87%). This suggests that inflation is yet to reach an inflection point. Hence, the decline in inflation is not likely to be sustained.



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[1] NBS, FDC Think Tank

Anecdotal evidence negates published data

The slight drop in inflation came as a surprise to investors, analysts and consumers. This is because anecdotal evidence suggests the exact opposite. Market proxies like the AFEX commodity index and retail prices in urban markets showed a spike in the general price level due to output shocks and supply chain disruptions emanating from heightened insecurity. Some analysts have attributed the slowdown in inflation to base year effects. In Q2'20, inflation rose mildly due to the immediate impact of panic buying amid output shortages and supply chain disruptions.

However, other analysts have raised eyebrows about Nigerian inflation falling at a time when global food prices are rising and US inflation climbed to a 11-year high of 4.2%. The global food index rose by 1.7% to 120.9 points in April. The naira has also lost 13.35% in the last 12 months ago. Notwithstanding, one month data is insufficient to form a trend. Hence, the conversation about inflation moderating when anecdotal evidence is moving in the opposite direction will be interrogated in weeks ahead.

Inflation: Directionally positive but nominally disturbing

Directionally, the drop in headline inflation could be cheery news to policy makers who had expected that increased fiscal stimulus and government interventions would spur output growth and taper inflation. However, nominally, inflation rate in Nigeria is still alarming. The current inflation rate is far above the natural rate of inflation. In the last decade, inflation in Nigeria averaged 11.2%, 6.92% lower than the current figure (18.12%). The CBN also noted that inflation rate above 12% is growth retarding. The GDP numbers are scheduled for release on May 24 and will be a major consideration at the MPC meeting next week. Notwithstanding, we expect the committee to carefully consider inflation expectations rather historical trend in determining its policy stance.

Reconstituting the CPI basket: Necessary to eliminate inflation bias

It is often advised that a country reconstitute its inflation basket periodically (5-years interval). This is to capture the changing consumption patterns of households. In Nigeria, the last time the basket constituents were revised was in 2009. This could 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.

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Inflation breakdown

Month-on-month inflation down sharply: weak aggregate demand to the rescue

On a monthly basis, inflation fell sharply by 0.59% to 0.97% (12.3% annualized) in April. The slow pace of increase in the monthly sub-index could be as a result of weak aggregate demand and tight liquidity in the banking system. In April, the opening position of banks was in the negative territory for 8 days. Also broad money supply (M2) fell slightly by 0.03% to N38.03trn in March.

Food inflation falling at a time when global food prices are rising

Over the years, food price movement has been a major driver of inflation in Nigeria. The year-on-year food inflation dipped 0.23% to 22.72% in April from 22.95% in March. On a monthly basis, it recorded a sharp decline of 0.91% to 0.99%. This could be as a result of base year effects and lagged impact of border re-opening. Food inflation increased steadily since the land borders were closed in August 2019 due to reduced supply. This was compounded by currency pressures and heightened insecurity (output shocks and supply disruptions). The borders were re-opened in December 2020 but food inflation continued to rise due to time lag effect.

A troubling trend however is that food inflation is falling at a time when global food prices are rising. The global food price index increased for the 11th consecutive month to 120.9 points in April, 1.7% higher than March's figure (118.8 points). This was driven by an increase in the sugar, oil and meat price indices.

Core inflation up 0.07%

Annual core inflation increased while month-on-month declined. On a yearly basis, the core sub-index increased by 0.07% to 12.74%. Coincidentally, it fell by the same magnitude to 0.99% on a monthly basis. The increase in the annual index cut across all non-food items particularly for healthcare (15.88%) and transport (14.87%).

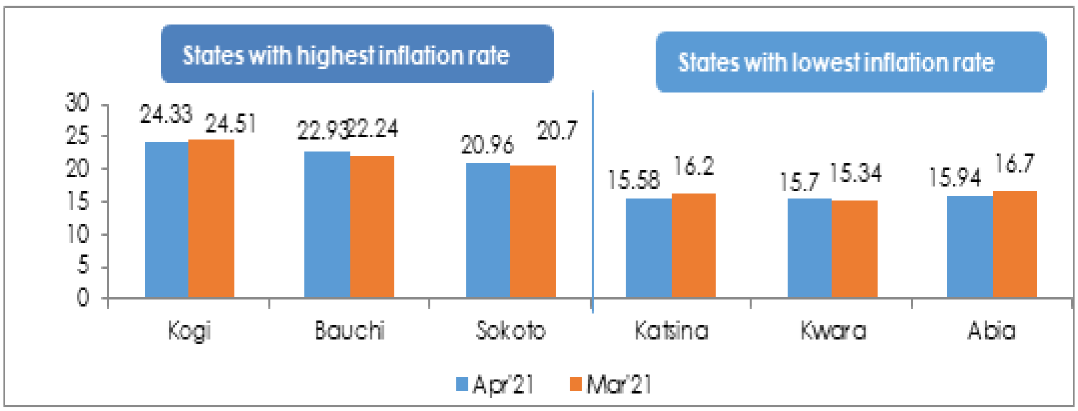
Rural and Urban

Both the rural and urban inflation sub-indices declined in April. On an annual basis, rural inflation fell by 0.03% to 17.57% while urban inflation declined by 0.08% to 18.68%. The rural-urban differential declined to

1.11% from 1.16%. On a monthly basis, rural inflation was down 0.57% to 0.95% while urban fell by 0.61% to 0.99%.

State-by-State Analysis – Inflation highest in the North

In April, Katsina had the lowest inflation rate (15.58%), followed by Kwara (15.7%) and Abia (15.94%). The states with the highest inflation rates are predominantly Northern states - Kogi (24.33%), Bauchi (22.93%) and Sokoto (20.96%).



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SSA Regional Trend: Food price trend – A major driver of inflation

Inflation trend in Sub-Saharan Africa has been largely driven by the food price trend and Nigeria is not an exception. Five of the SSA countries under our review recorded lower inflation rates, primarily as a result of a slowdown in the food sub-index.

In spite of the gradual economic recovery, all the SSA countries under our review left their monetary policy rates unchanged. This is to further monitor and assess the impact of the various fiscal stimuli. Nigeria is also likely to leave its monetary parameters unchanged and continue to assess the macroeconomic environment.

Country	April Inflation (%)		Most Recent Policy rate (%)	
Nigeria	18.12	↓	11.50	↔
Angola	24.82	↑	15.50	↔
Kenya	5.76	↓	7.00	↔
South Africa	3.2 (Mar)	↑	3.50	↔
Ghana	8.5	↓	14.50	↔
Uganda	2.1	↓	7.00	↔
Zambia	22.7	↓	8.50	↔

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[2] NBS, FDC Think Tank
[3] NBS, Trading Economics, FDC Think Tank

Inflation Outlook

All eyes will now be on the MPC at their meeting next week to see their reaction to the unexpected drop in inflation. The GDP numbers are scheduled for release on May 24. We are projecting a mild contraction of 0.5%. Our view is that the committee would maintain its current stance and watch the indicators closely. This is because inflation is likely to increase again in the month of May due to output shocks and supply chain disruptions as a result of heightening insecurity. This will be compounded by exchange rate pressures and higher logistics costs.