FDC Economic Bulletin

June 08, 2021

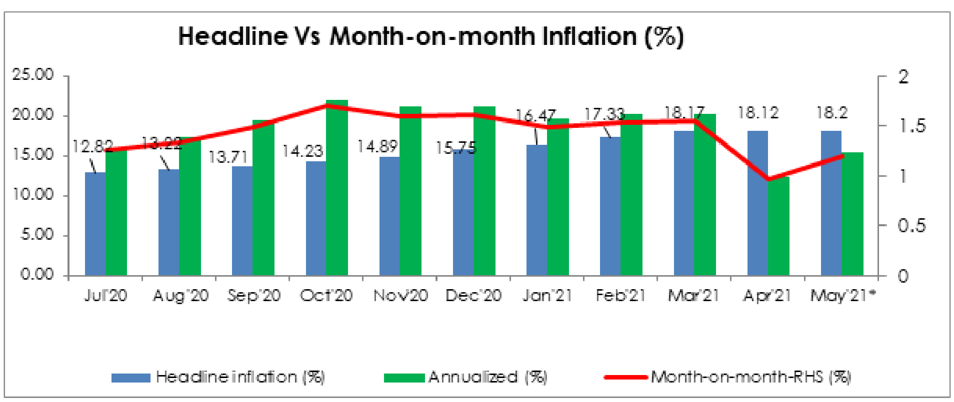
Headline inflation to increase again - 18.2% in May

Based on our time series model and market survey, headline inflation is likely to increase to 18.2% in the month of May from 18.12% in April. The earlier news that headline inflation slipped marginally in April 2021 was received with a certain amount of skepticism by analysts. This was mainly due to the fact that anecdotal proxies seemed to be running contrary to the data. The question on the minds of most analysts is if this drop was a blip or a trend.

What also raised eyebrows was the statement by the FAO that global food prices are at a 10-year high of 4.8%. Therefore, it becomes more difficult for analysts to comprehend how food inflation in Nigeria would be running in the opposite direction of the global food basket. Food inflation is projected to rise to 24.15% in May.

In addition, inflation in the US climbed to a 13-year high of 4.2% in April. The consensus forecast is for an increase to 4.7% in May. In the UK, inflation doubled from 0.7% in March to 1.5% in April. This is the highest level since March 2020. In Sub-Saharan Africa, four of the countries under our review (Angola, Kenya, South Africa and Zambia) recorded higher inflation rates. Apart from Kenya, these countries have inflation rates higher than their interest rates.

Apart from the anticipated rise in headline (y-o-y) inflation, our model also indicates a sharp increase in monthly inflation to 1.2% (15.34% annualized) from 0.97% (12.3% annualized) in April. Core inflation (inflation less seasonalities) is also likely to creep up to 13.32% from 12.74% in April.



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[1] NBS, FDC Think Tank

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Is inflation transient or structural?

Global economists are struggling with differentiating between the features of the current inflation trend. Whilst the Fed insists that the recent inflation looked more transient, some others like Larry Summers believe that the wage increase and stimulus package may lead to a more protracted inflation spiral. In Nigeria, current inflation is driven by a number of factors - some structural and some transient.

- ***Money supply growth (M2):*** Theoretically, money supply growth is a fundamental driver of inflation especially in the short-run. However, in the long term, it unlocks unemployed resources. Broad money supply jumped by 20.09% to N38.38trn in April 2021 from N31.96trn in April 2020 and is projected to increase towards N40trn in June.

- ***Fiscal deficit:*** Economists are of the opinion that an increase in fiscal deficit could fuel inflationary pressures. This is because increased government borrowing especially through ways and means advances would boost liquidity and exert inflationary pressures.

- ***Exchange rate pass through effect:*** Imported inflation has remained high due to currency pressures. In recent times, the blend between official and autonomous rate has improved to 20:80 from 10:90. This is expected to reduce the average blended rate to N450-460/$ from N476/$ in Jan'21, pointing to a possible reduction in import costs.

- ***Insecurity:*** Insecurity has been a major disruptor to the commodities value chain. Our market survey revealed that commodities with the highest price increases are grown in the North. In the last 5 months, the price of beans increased by almost 50%, tomatoes jumped by 285% while pepper surged by 300%. The Onion Producers and Marketers Association of Nigeria has threatened to stop the supply of onions to the South. This could push up the price of onions to over N40,000 per bag from its current price of N21,000.

- ***Higher energy costs:*** State governors have agreed to a full deregulation of the downstream sector, which points to a possible increase in the price of PMS to N385/$ in the near term. Average petrol price increased to N165/litre in 2021 from N145/litre in 2020. Transport and logistics account for 6.51% of the inflation basket. Also, there is likely to be another electricity tariff hike in July.

Inflation Trend in Sub-Saharan Africa: 4 Reds; Two Greens

According to the EIU, SSA inflation is estimated to average 8.1% in 2021 before falling to 8.0% in 2022. The inflationary trend across SSA is a mixed bag. Four of the SSA countries under our review recorded higher inflation while two posted a decline. Food price movement and transport costs largely determined the inflation trend.

Of the SSA countries under our review, only the Bank of Ghana reduced its benchmark interest rate to support the country's economic recovery.

Country	May Inflation (%)		Most Recent Policy rate (%)	
Nigeria	18.2*	↑	11.50	↔
Angola	24.82 (April)	↑	15.50	↔
Kenya	5.87	↑	7.00	↔
South Africa	4.4 (April)	↑	3.50	↔
Ghana	8.5 (April)	↓	13.50	↓
Uganda	1.9	↓	7.00	↔
Zambia	23.2	↑	8.50	↔

[2]

Inflation outlook in Q3

Whilst the controversy rages on whether the current inflation is reflective of reality, we must bear in mind that the CBN has been consistent in its contention that an inflation rate above 12% is growth retarding. It has also been resolute in its belief that a stable exchange rate is an antidote to rising inflation.

Inflation has its seasonality features and core inflation, which discounts seasonal factors from headline inflation, is expected to be relatively mild this time. Whilst the planting season effect will take a toll on prices in the next quarter, one feature of the planting season this year is that farmers who normally consumed only grains are now consuming seeds and grains. Seed consumption reduces the planting stock and slashes the harvest of next season. Therefore, we should expect some shortages in food output next quarter in addition to higher logistics costs and ultimately higher food inflation in Q3.

[2] NBS, Trading Economics, FDC Think Tank

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