FINANCIAL DERIVATIVES COMPANY

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Economic Bulletin

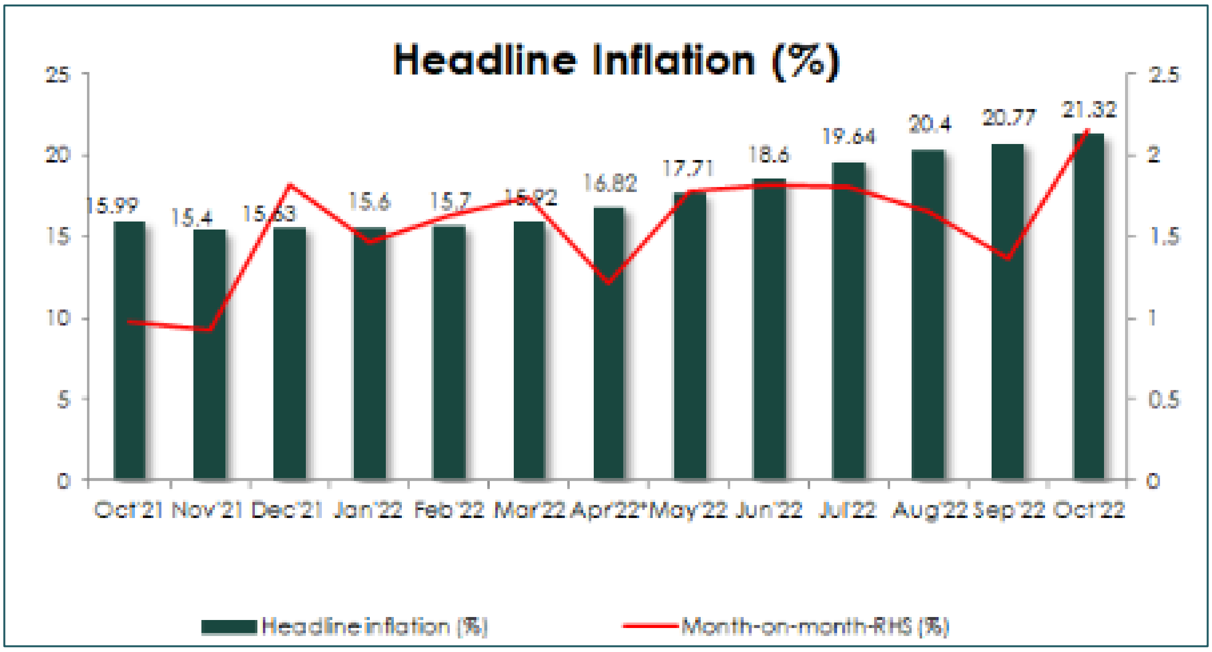
Headline Inflation

Projected to Spike to 21.32%

21.32%

Projected Official headline inflation rate for Nigeria

The Nigerian Bureau of Statistics will release its consumer price index report for the month of October on November 15. Based on our econometric model and market survey in Lagos and its environs, Nigeria's headline inflation is projected to increase again by 0.55% to 21.32% in October. Food inflation will rise by 0.62% to 23.95%, while core inflation will increase by 0.18% to 20.5%. If our estimates are accurate, it will be the ninth consecutive monthly increase and the highest rate of inflation in 17 years.



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[1]NBS, FDC Think Tank

In contrast to the general expectation that harvest would drive down market prices, the food basket experienced a faster rate of price acceleration. This can be attributed to the significant shortage in the supply of agricultural products as a result of the floods that ravaged major food-producing states.

Furthermore, the interaction of higher logistic costs and the exchange rate pass-through effect is keeping the price of the non-food basket above reach. The naira has lost over 15% of its value relative to the dollar in the last one month. Energy prices, including diesel and gasoline, have remained elevated, with diesel price hovering between N790 and N850 in the past month. Moreso, we expect month-on-month inflation to increase by 0.8% to 2.16% as the effect of floods outweighs the benefit of the typical harvest season in the month of October.

Monthly inflation

To: **2.16%**

By: ▲**80bps**

From: **1.36%**

Food Inflation

To: **23.95%**

By: ▲ **62bps**

Core Inflation

To: **20.50%**

By: ▲ **18bps**

Matters Arising

Floods to keep food inflation elevated

The impact of the floods that swept more than 26 states under water will continue to undermine the positive impact of the harvest period. Typically, Nigerian headline inflation and food inflation taper from September to November every year, reflecting the core harvests that occur in the period. However, the recent floods in the major food-producing states will rob the country of the price-moderation effects of the harvest season. This, coupled with higher logistics costs, that have been exacerbated by the resurfaced fuel scarcity in the major cities, will keep food inflation elevated in the coming months. Food inflation has maintained an upward trend since January. It has increased by 6.21% in the last ten months.

Selected commodities and their prices

	Sep'22	Oct'22	%Change
Tomatoes	N25,000	N25,000	0.0
Onions	N40,000	N46,000	15.0
Bread	N800	N800	0.0
Rice	N35,000	N45,000	15.0
Bean (Oloyin)	N38,000	N39,000	2.6
Gas (12kg)	N10,800	N10,000	-7.41
Pepper	N25,000	N20,000	-20.0
Melon Seeds	N2,200	N4,000	81.8
Yam (medium size)	N2,000	N1,700	-15.0
Noodles	N3,700	N3,700	0.0
Palm Oil	N4,700	N5,000	6.4
Sugar (St. Louis - 1pkt)	N750	N800	6.7
Bournvita 450g	N1,800	N1,900	5.6
Baby Food (Cerelac)	N4,500	N4,800	6.7
Magerine (Blue Band-Big)	N1300	N1300	0.0
Semovita (10kg)	N6300	N6300	0.0
Average			**6.09**

The CBN is set to redesign some currency notes

The Central Bank of Nigeria has announced the redesign of three of the eight denominations of Nigeria's legal tender. The naira notes affected are the N200, N500, and N1,000 denominations. The affected denominations will cease to be legal tender on January 31, 2023. The redesign is attributed to challenges such as significant hoarding of bank notes by members of the public, a worsening shortage of clean banknotes in circulation, and the higher ease of counterfeiting and parsing the currency.

Analysts are skeptical as to what the impact of the policy will be on the general price level (inflation) and output. The initiative will only lead to monetary exchange: cash holdings will be exchanged for demand deposits. This does not essentially reduce the supply of money and may not affect the general price level.

Also, the ratio of currency outside banks to money supply has not changed substantially in the past decade. In fact, it declined marginally from 5.65% in August 2021 to 5.43% in August 2022. In the same period, money supply grew year-on-year by 20.54%. This suggests that it could be a narrow economic judgement to conclude that currency in circulation outside the bank vaults is the major driver of money supply. Although the initiative may not strengthen the effectiveness of monetary policy as envisaged by the monetary authority, it could have unintended consequences for the exchange rate. This is because the forex markets are usually a subject of panic and speculation.

Already, the naira has been tanking against the dollar since the announcement was made, exceeding N800/$ in the parallel market. This new development could lead to the dollarization of the domestic economy or a sharp increase in electronic payments and settlements of transactions. Heightening the upside risks to inflation in the near to medium term.

Inflation trend in Sub-Saharan Africa

Inflation rates in Sub-Saharan Africa remain stubbornly high. October is the typical harvest period for most African countries that lie on the coast. The harvest is expected to ease the heightened pressure on domestic prices. But the currency pressures, ballooning debt and external shocks have continued to undermine the impact of farm harvests on domestic prices in some parts of the region.

Three out of the seven countries that are tracked by the FDC (Angola, South Africa and Zambia) recorded decelerating inflation rates. The downward inflation trajectory can be largely attributed to a bumper harvest and increase in food supply, which led to a decline in food prices.

African central banks to slow on monetary tightening

While inflation rates are still maintaining upward trends in most African countries, the fragile economic situation will necessitate that African central banks reduce the acceleration of their interest rate hikes. However, advanced economies seem to have made the choice to rather risk a temporary recessionary dip than allow spiraling inflation to distort their macroeconomic stability. In a bid to taper inflation, the US Fed raised the target range for the federal funds rate by 75bps to 3.75%p.a - 4% p.a. in November. This makes the fourth straight 75bps increase and a cumulative of 300pbs so far in the year, pushing borrowing costs to a 14-year high. The Fed, however signaled that rates could peak higher but at a slower pace. The Bank of England also increased its policy rate by 75bps to 3%p.a this month, the largest interest rate hike in 33years. However, the peculiar structural problems in developing economies have limited the capacity of interest rate hikes to rein in inflation. Despite Ghana's increase in interest rate by 1000bps and Nigeria's increase by 400bps cumulatively this year, inflation has remained stubbornly high in these countries. African inflationary problems can be largely attributed to currency depreciation. The Ghanaian cedi has depreciated by 125.03%, and the Nigerian naira has lost 50.79% of its value year-to-date. The depreciation of the currencies of major African countries implies that the price of imported food items, such as wheat will surge. Our empirical findings show that the exchange rate has contributed to over 70% of the inflationary pressure in 2022.

Country	October Inflation (%)		Most Recent Policy rate (%)	
Nigeria	21.32*	▲	15.5	▲
Angola	18.16 (Sep)	▼	19.5	▼
Kenya	9.6	▲	8.25	▲
South Africa	7.5 (Sep)	▼	6.25	▲
Ghana	37.2 (Sep)	▲	24.5	⟷
Uganda	10.7	▲	10	▲
Zambia	9.7	▼	9	⟷

Concluding thoughts

The inflation rate is likely to remain elevated throughout the year as the impact of floods overshadow the benefit of harvests. We expect the Monetary Policy Committee to keep the policy rate unchanged at its next meeting on November 22, 2022.

Important Notice

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