FINANCIAL DERIVATIVES COMPANY

Economic Bulletin

AUG 08 2023

Headline Inflation

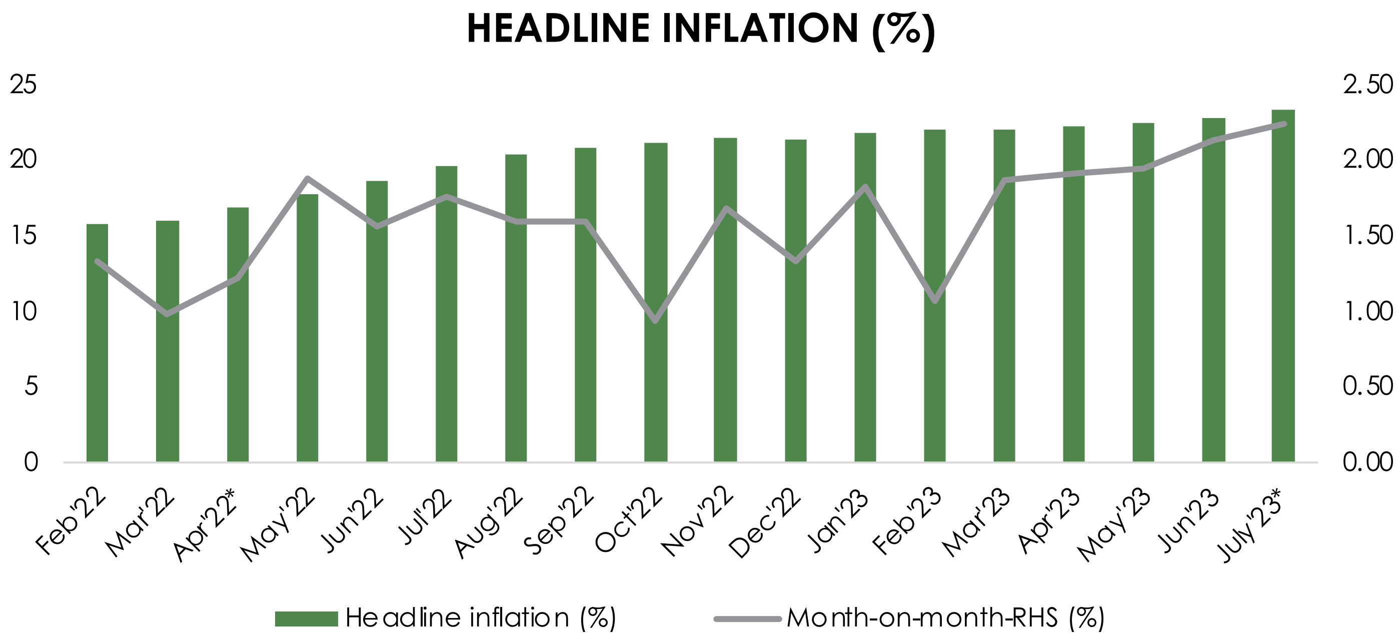
Likely to rise to 23.35% as policy impact fully manifests

23.35%

Projected headline inflation rate for Nigeria

The CPI report for the month of July will be released by the Nigerian Bureau of Statistics on August 15. At Financial Derivatives Company (FDC), we are projecting a further increase in headline inflation to 23.35% from 22.79% in June. This would mark the seventh consecutive monthly increase and the highest inflation rate in 18 years.

Apart from the sustained uptick in the general price level, the slope of the inflation curve is becoming steeper (i.e. the rate of change in inflation is increasing). This is an indication that the impact of recent policy changes is becoming more evident. In a period of one month, the price of PMS has increased twice, first to N488/ltr and then to N617/ltr. Diesel price is also up 5.88% to N720/ltr from N680/ltr, pushing up transport and logistics costs. In addition, the naira touched an all-time low of N893/$ at the parallel market.



NBS, FDC Think Tank

Our econometric model also suggests an increase in all components of inflation. Notably, food inflation is estimated to rise by 0.33% to 25.58% while core inflation (inflation less seasonalities) is projected to increase by 0.22% to 20.49%. Month-on-month inflation, which reflects the current economic situation will most likely surge by 0.15% to 2.28% (31.12% annualized).

Inflation breakdown

Higher logistics costs & currency depreciation could limit harvest season effect

Food prices are typically affected by seasonality, increasing during the planting season and reducing during harvest due to increased supply. However, the surge in logistics costs, naira depreciation, and the customs duty exchange rate adjustment could keep commodity prices elevated despite the commencement of the harvest season.

Also, the closing of some of the land borders and India's ban on rice exports would reduce supply and further stoke pricing pressures. Food inflation is expected to rise by 0.33% to 25.58%.

Currency depreciation and rising logistics costs to drive up core inflation

Core inflation, which is inflation less volatile items like food and energy costs, is expected to increase by 0.22% to 20.49% in July. This increase will be driven by naira depreciation and rising logistics costs. In July, the naira depreciated sharply by 10.92% at the parallel market to close the month at N870/$ while the price of PMS increased further by 23.4% to N617/ltr. Diesel price is also up 5.88% to N720/litre from N680/litre. The continued surge in core inflation is an indication that inflation in Nigeria is not only transient but is structural. It will therefore take time before it will begin moderating sustainably.

Monthly inflation

To: **2.28%**

By: ▲**15bps**

From: **2.13%**

Food Inflation

To: **25.58%**

By: ▲ **33bps**

To: **20.49%**

By: ▲ **22bps**

Core Inflation

Nigeria's inflation defies economic logic

Interest rate hikes have proven to be effective to curb inflation. For instance, the US raised its monetary policy rates by a cumulative of 500bps and inflation fell to 3% in June 2023 from its peak of 9.1% in June 2022. This is also the case in the UK where the Bank of England hiked its benchmark interest rates by 490bps and inflation slowed to 7.9% in June 2023 from its peak of 11.1% in October 2022.

However, Nigeria's inflation has maintained an upward trajectory despite the CBN's hawkish stance. This is because monetary policy could be limited in a fiscally dominated economy. The cocktail of measures to contain inflation will include:

- Moving subsidies from consumption to production
- Increasing forex supply to import goods to push down prices
- Shift in the aggregate supply curve i.e. the production possibility frontier

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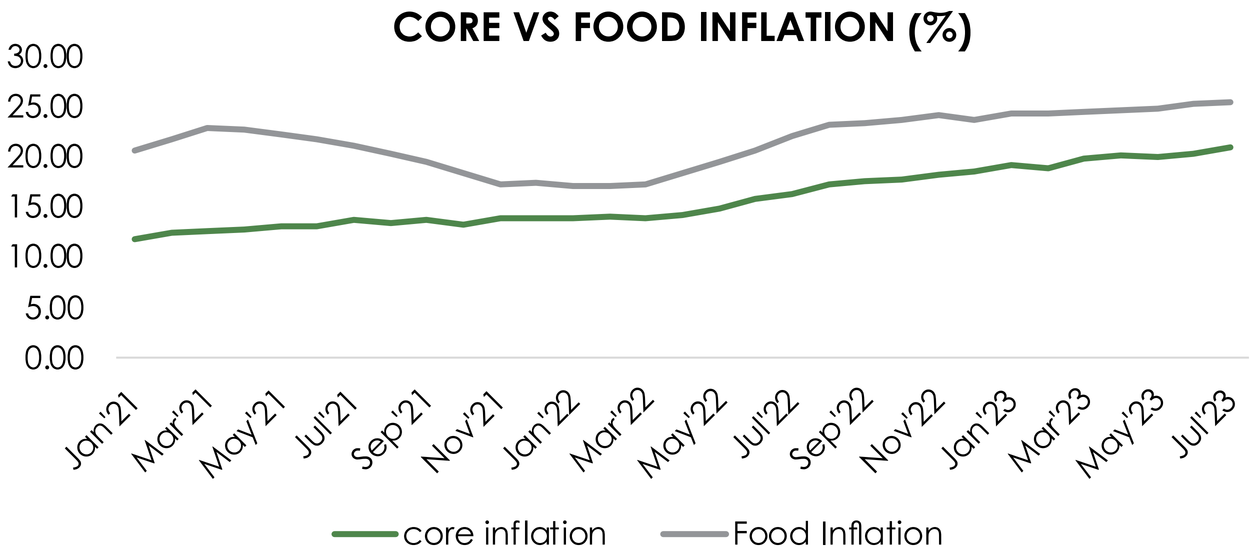

NBS, FDC Think Tank

Country	Inflation (%)		Most Recent Policy rate (%)	
Nigeria	23.35*	▲	18.75	▲
Angola	11.25	▲	17	⟺
Kenya	7.3	▼	10.5	▲
South Africa	5.4	▼	8.25	⟺
Ghana	42.5	▲	30	▲
Uganda	3.9	▼	10	⟺
Zambia	10.3	▲	9.5	⟺

*FDC Forecast

Inflation trend in sub-Saharan Africa

On the regional front, some African economies like Kenya, South Africa, and Uganda recorded a decline in their inflation rates. Notably, South Africa's inflation moderated to 5.4% in June, marking a 19-month low. This was mainly due to a decline in the prices of food and non-alcoholic beverages.

However, inflation in Angola, Ghana, and Zambia rose due to the depreciation of their currencies. This contributed to higher cost of imported goods and mounted upward pressure on food prices. Following a pattern observed in many advanced economies, African Central Banks maintained their hawkish monetary policy stance to mitigate the impact of inflationary pressures.

Inflation to remain elevated in the near term

Nigeria's inflation is expected to remain elevated in the near term despite the harvest season, which commenced in the third quarter. This will be largely driven by currency pressures and higher logistics costs.

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