INFLATION FORECAST

OCTOBER 08

SEPTEMBER

32.37% - Headline
36.59% - food

20
24

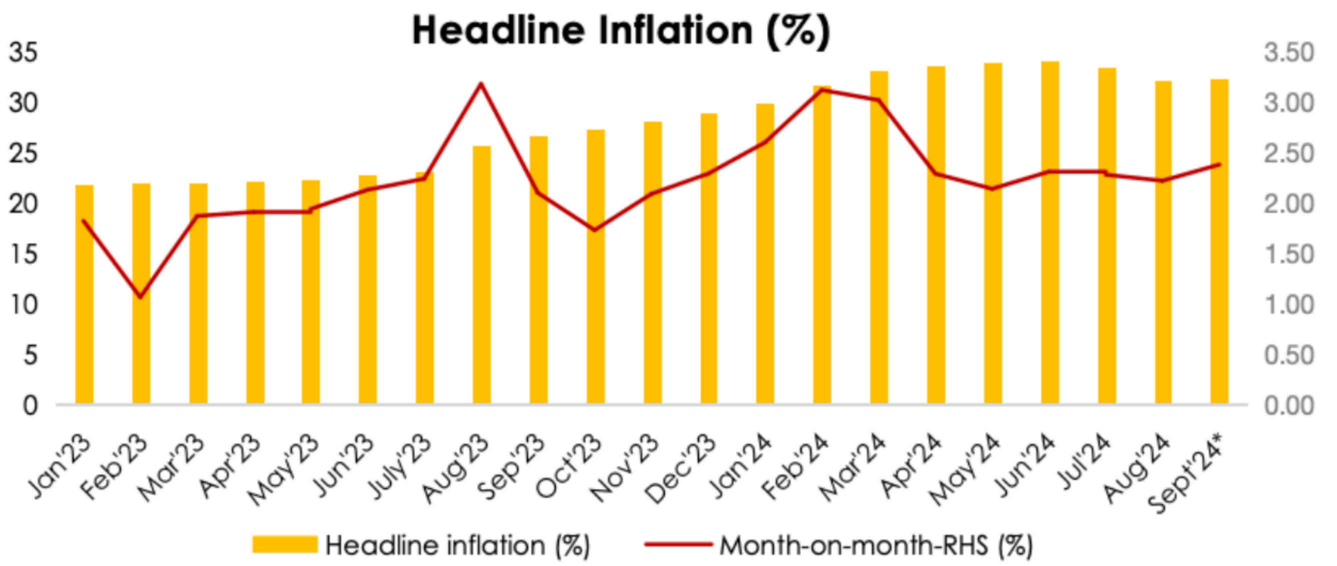
After two months of decline, Headline inflation is blinking red again

32.37%

Headline inflation forecast for Nigeria

A few skeptical analysts were of the view that the declining trend of inflation was too good to be true. Projections from our September inflation survey seem to confirm the saying that if it sounds too good to be true, it probably is. We are estimating a marginal increase in both headline and monthly inflation. The trend of falling inflation is being bucked for some reasons – the new petrol price, which led to higher transportation and logistics coupled with exchange rate volatility and floods in northern Nigeria, which will undermine agricultural production.

The September inflation numbers will be released by the NBS on October 15. At FDC, we project that the headline inflation will increase marginally by 0.22% to 32.37%. This will bring an end to the declining trend that commenced in July. The harvest season has been primarily responsible for the disinflation in the last two months. However, its price moderating impact in September was, to a large extent, limited by the higher petrol price and exchange rate depreciation. This development led to supply shortages of some essential commodities such as rice, beans,



[1]

[1] NBS, FDC Think Tank

chicken, etc., thus creating market disequilibrium. The resulting impact of this was a spike in the prices of these commodities. For instance, the price of a 50kg bag of rice increased by 36% to ₦120k in September from ₦88k. A bag of beans now sells at ₦180,000 from ₦160,000.

However, annual and monthly food inflation will continue its declining trend to 36.59% and 2.21% from 37.52% and 2.37% respectively due to harvest season. The effect of the boost in food supply more than compensated for the increase in logistics costs– as prices of commodities like tomatoes (10%), onions (20.7%), and Garri (5%) declined from the previous month. While the price of Palm oil, yam, egg sweet, and Irish potatoes remained unchanged.

Month-on-month inflation on a steep rise

In the same vein, we anticipate a moderate increase in the month-month inflation by 0.16% to 2.38% (32.66% annualized) from 2.22%. The monthly index is a better reflection of current prices and inflation expectations. The index was more reflective of the higher petrol price effect.

Core inflation to sustain its increasing trend

The core sub-index (inflation less seasonalities) both annually and monthly is likely to increase marginally by 0.18% to 27.73% and 0.09% to 2.36% respectively in September. This will be buoyed by higher petrol prices as well as the instability in the exchange rate. The wholesale price of petrol in Lagos increased by almost 50% to ₦1,000.00 per liter, increasing logistics and distribution costs for traders and some firms who use petrol for production by about 30%. At the parallel market, the naira depreciated by 5% to ₦1, 700/$.

Monthly inflation

To: 2.38%

By: ▲16bps

From: 2.22%

Food inflation

To: 36.59%

By: ▼93bps

From: 37.52%

Rational consumers are downtrading

Typically, consumers when confronted with an erosion of income will change their preference in favour of cheaper substitutes or engage in downtrading. This is because of the value-for-money incentive resulting from their budget constraints. There is empirical evidence to show that both in quality of purchases and quantity Nigerian consumers have reduced their spending in line with this trend. The effect is that corporates are reporting an increase in the value of their turnover but a reduction in the volume produced. For example, the flour millers have pushed their prices up from ₦35k a year ago to ₦65k. Sales are up, but volume is down.

Petrol prices – Equilibrium inevitable

Nigeria has to wean itself off subsidies to achieve price equilibrium. Allowing market forces to determine fuel prices will better reflect production costs, drive efficiency, and promote investment in local refining capacity. Though the removal of subsidies may result in a short-term price increase, targeted social programs can cushion the impact on vulnerable groups.

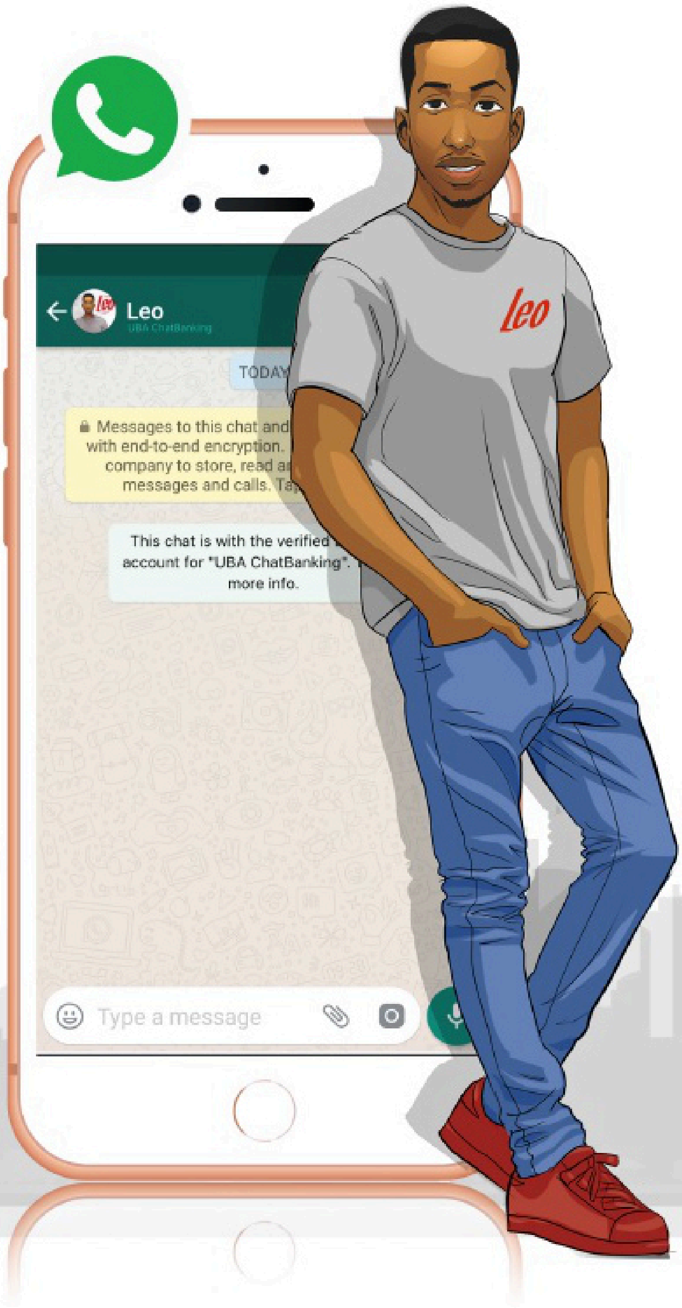
Outlook

The possible upward reversal in the inflation trend will be a major consideration at the MPC meeting in November. The likelihood of maintaining the status quo is very high because of the aggressive hike in September by 50 basis points to 27.25%p.a. This is to prevent the economy from overheating and a possible recession.

UBA
United Bank for Africa

Leo
on WhatsApp

Chat on +234-903-000-2455



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