

Economic Report | Inflation
Base effects dictate inflation trajectory
Economic Snapshot

March 2017 Inflation Data/Indices			
	MoM	YoY	Prev YoY
Headline	1.7%	17.3%	17.8%
Food	2.2%	18.4%	18.5%
All Items Less Farm	1.3%	15.4%	16.0%
Imported food	1.5%	18.1%	19.4%
Energy	1.4%	22.5%	24.1%
Currency Markets			
	Latest	Daily Chg	YTD
USDNGN	306.0	-0.02%	0.3%
EURNGN	335.2	0.2%	-3.7%
GBPNGN	392.9	-2.0%	3.9%
JPYNGN	281.0	-0.4%	6.8%
Monetary Aggregates – February 2017			
	(₦bn)	MoM	YoY
M2	22,365	-4.3%	8.5%
CPS	22,362	0.1%	17.4%
NCG	4,408	2.9%	25.3%
NFA	8,547	-11.3%	56.2%
NDG	26,771	0.5%	18.6%
External Position			
	Latest	QoQ	YoY
Trade Balance (\$'mn)	185.73	-21.5%	N/A
External Reserves (\$'mn)	30,440	19.8%	4.3%
Foreign Debt (\$'mn)	11,406	0.9%	10.4%
Growth Data – Q4 2016			
	(₦bn)	%of total	YoY
Real GDP	18,292	100%	-1.3%
Agriculture	4,662	25.5%	4.0%
Oil	1,338	7.2%	-12.4%
Services	6,865	37.5%	-1.6%
Wholesale and Trade	3,046	16.7%	-1.4%
Manufacturing	1,757	9.6%	-2.5%

Amaka Ukoha
amaka.ukoha@arm.com.ng

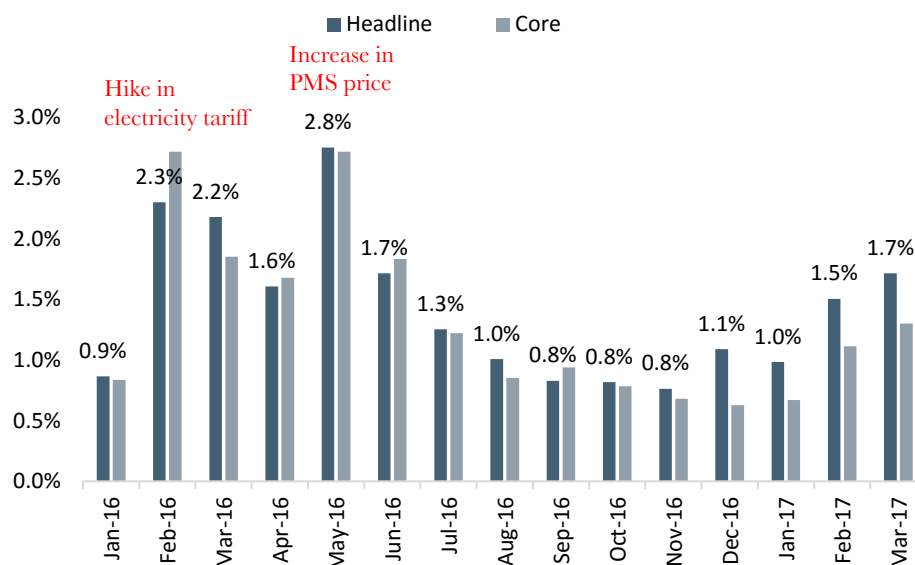
Nigeria's headline inflation decelerated for the second consecutive month (-50bps) to 17.3% in March – though lagging the scale of moderation in prior month's reading (-92bps). Instructively, the reading was significantly behind Bloomberg consensus estimate of 16.7% as changes in food inflation (-10bps to 18.4% YoY) failed to keep pace with expected impact of naira gains at the parallel market in the review month. That said, high base effect from 2016 electricity and PMS price hikes saw core inflation decelerate a further 60bps to 15.4% to dictate overall YoY headline trajectory. On a MoM basis, headline inflation increased by 1.72% (vs. 1.49% in prior month's reading) largely reflecting unyielding food pressures (MoM: 2.21%).

Core reading bows to base effect yet again

Focusing on core inflationary movements, breakdowns indicate a 1.32% MoM increase in the core basket buoyed by increases in prices of miscellaneous services related to dwelling, solid fuels, clothing materials, spirits, lubricants, and personal transport. Also, despite moderation in prices of some known energy components (PMS (-0.3% MoM), Kerosene (-14.2% MoM) and Diesel (-5.4% MoM)), pressures from other sources (e.g. solid energy) drove energy inflation higher to 1.4% MoM. The foregoing combined with the pressures on miscellaneous services front drove core inflation higher in the review month.

Overall, despite core inflationary pressures suggested by the MoM readings, the impact of high base remained evident on YoY numbers as increases in PMS (+10% YoY), kerosene (+54% YoY), and diesel (+60% YoY) in March failed to stall YoY core deceleration.

Figure 1: Trend in MoM headline and core inflation



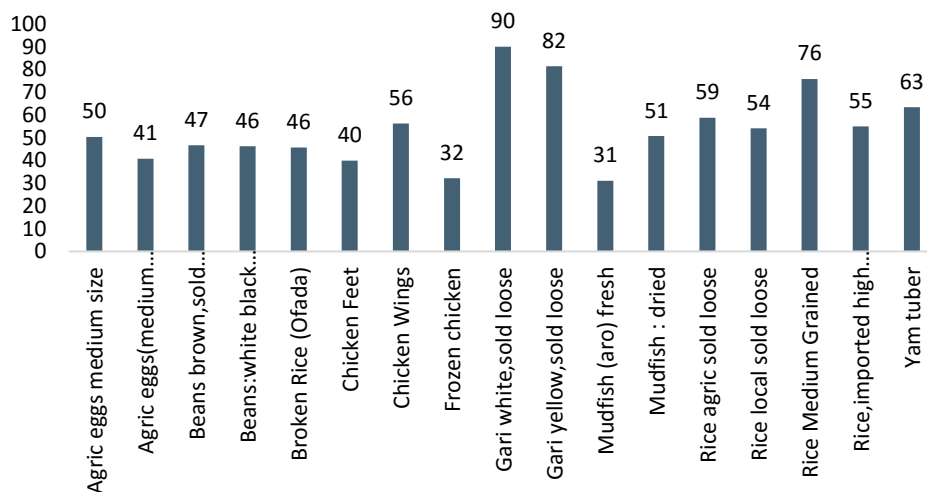
Source: NBS, ARM Research

Food pressures show no sign of abating

In line with the trend recorded over the prior months, MoM food inflation increased sharply by 2.2% (vs. February reading of 1.99%) despite naira gains at the parallel market in March. According to FEWSNET, pressures on Nigeria’s farm produce prices persisted despite recent gains in foreign reserve (+0.4% to \$30.4 billion) and direct government intervention due to structural challenges, restriction on use of forex reserve for food imports as well as higher transactions and transportation cost (March transport inflation: +1.2% MoM, +15% YoY) in the review period. Specifically, while government’s interventions—including Anchor Borrowers programme—slightly increased areas cultivated, initiatives to curb transport challenges (i.e. grain by rail) were yet to kick-in to stem the major transport setback in the review month. Importantly, MoM transportation inflation have steadily increased in the last three months, with the March reading (1.2% MoM) printing at the highest level since July

2016, following price hikes by major transport associations across the country in response to the sharp jump in Diesel prices in December. For context, we note that the cost of transportation between assembly markets in North Central and other Northwest states of Nigeria, particularly to Dawanau market in Kano, increased by about 70% compared to last year.

Figure 2: Changes in selected food prices across Nigeria (% YoY)



Source: NBS, ARM Research

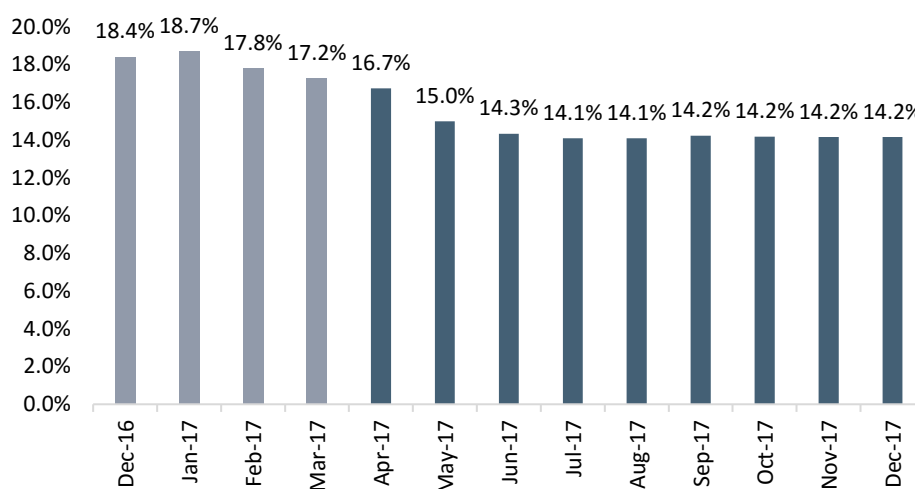
Core decelerations to define headline momentum

Going forward, we expect impact of high base effect to continue to dictate core inflation and overall headline trajectory despite concerns on the food inflation front. Precisely, high base effect from the 45% and 68% increases in electricity and PMS prices in 2016 should leave YoY core reading subdued with recent gains in PMS, kerosene, and diesel prices leaving sizable scope for sustained decelerations. However, we are less sanguine on the food side of things over the near term owing to recent pressures from higher transactions and transportation costs. That said, the more recent retrace in diesel prices suggests that pressures from the transport front would be less impacting in coming reading. In addition to this, the incentive of higher prices and FG's continued push on the Anchor Borrowers Program front are notable signposts of gradual near and medium term gains relating to domestic food availability respectively. On the former, we expect farmers to sustain their ramp up of output in April offseason harvest as higher prices continue to provide

the needed incentive. Thus, with lagged impact of naira gains at the parallel market also raising scope for temperance in demand pressures from neighbouring West Africa, pressures on food inflation should be relatively contained in the coming reading compared to that of the prior month. On balance, we expect moderation in core inflation to offset pressures from food inflation. Against this backdrop, we now look for headline reading of 16.7% YoY for April with 2017 mean now printing at 15.4% YoY (2016: 15.6% YoY).

In terms of market impact, elevated MoM inflation reading provide another justification for CBN to leave its hawkish monetary policy intact over the near term. That said, given the impact of contractionary monetary policy on FG’s borrowing cost with April 2017 subscription (₦111 billion) significantly below amount on offer (₦135 billion), we think pressures from the fiscal authorities could compel some form of monetary easing over H2 17.

Figure 3: 2017 inflation forecasts



Source: NBS, ARM Research

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