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## Economic Report | Inflation

# *Nigerian Inflation: Base effect to bow out as food pressures dictate CPI tone*

**Economic Snapshot**

| May 2017 Inflation Data/Indices | MoM | YoY | Prev YoY |
|---|---|---|---|
| **Headline** | 1.9% | 16.3% | 17.3% |
| **Food** | 2.5% | 19.3% | 19.3% |
| **All Items Less Farm** | 1.2% | 13.0% | 14.8% |
| **Imported food** | 1.3% | 15.0% | 17.0% |
| **Energy** | 1.3% | 16.3% | 18.8% |

| Currency Markets | Latest | Daily Chg | YTD |
|---|---|---|---|
| **USDNGN** | 305.3 | 0.15% | -0.1% |
| **EURNGN** | 350.8 | -0.1% | -7.2% |
| **GBPNGN** | 401.6 | -0.1% | -4.3% |
| **JPYNGN** | 283.0 | 0.4% | -6.0% |

| Monetary Aggregates – April 2017 | (₦'bn) | MoM | YoY |
|---|---|---|---|
| **M2** | 21,713 | -1.4% | 4.8% |
| **CPS** | 21,943 | -1.5% | 13.2% |
| **NCG** | 5,592 | 7.5% | 42.2% |
| **NFA** | 7,262 | -4.1% | 43.2% |
| **NDC** | 27,535 | 0.2% | 18.1% |

| External Position | Latest | QoQ | YoY |
|---|---|---|---|
| **Trade Balance ($'mn)** | 185.73 | -21.5% | N/A |
| **External Reserves ($'mn)** | 30,289 | 0.95% | 3.68% |
| **Foreign Debt ($'mn)** | 13,808 | 21.1% | 23.3% |

| Growth Data – Q1 2017 | (₦'bn) | %of total | YoY |
|---|---|---|---|
| **Real GDP** | 15,861 | 100% | -0.5% |
| **Agriculture** | 3,385 | 21.3% | 3.4% |
| **Oil** | 1,411 | 8.9% | -11.6% |
| **Services** | 5,975 | 37.7% | 1.0% |
| **Wholesale and Trade** | 2,819 | 17.8% | -3.1% |
| **Manufacturing** | 1,543 | 9.7% | 1.4% |

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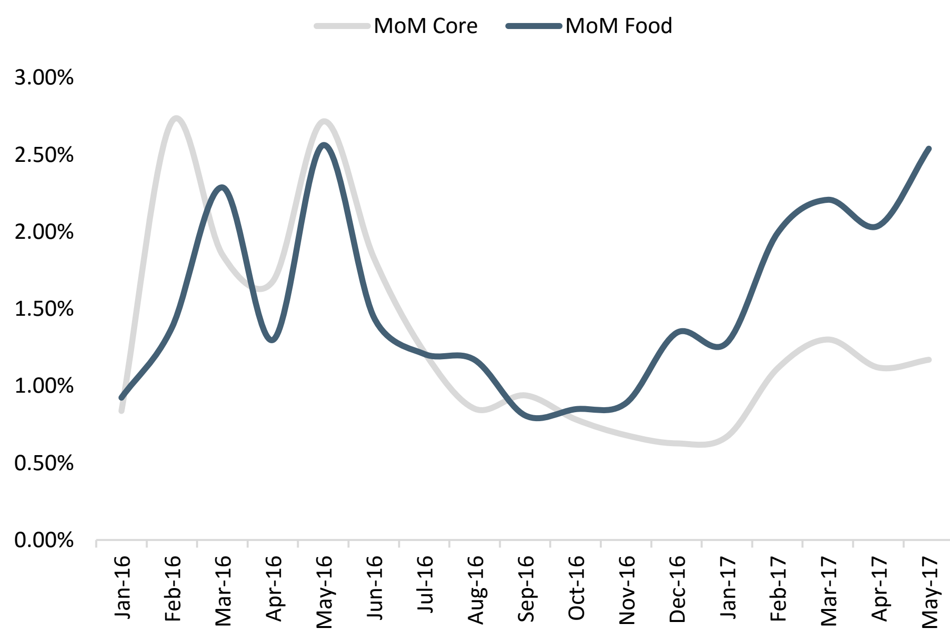
Nigerian inflation continued its descent in May to an annual rate of 16.25%, down from 17.3% in April – the fourth consecutive deceleration in 2017. The moderation in CPI was reflective of another sizable down-leg in core inflation owing to impact of high base effect from 2016. To be clear, while MoM core inflation was 5bps higher at 1.2% (vs. April reading), the YoY reading materially moderated (-173bps from prior reading to 13% YoY) in the review month to provide validation to our thesis. Particularly, breakdowns provided revealed that moderations in HWEGF (-314bps to 13% YoY) and other energy-related sub-core components were central to the further southward swing in core inflation. To buttress, increases in PMS prices have been subdued (+0.3% YoY to ₦150.70 per litre).

### *Food inflationary pressures: any cure in sight?*

Notwithstanding the slight temperance in YoY food reading from prior month to 19.27% YoY—a reflection of similar base effects, MoM reading printed at its highest level in 12 months (+2.54% MoM) with the NBS noting highest increases in prices of bread and cereals, meat, fish, tubers, and vegetables. Though much has been said of the potential impact of naira appreciation on the food basket—with regards to its capacity to tame rising demand pressures from neighbouring West African countries, structural bottlenecks such as higher transport inflation have largely restricted potential pass-through in our view.

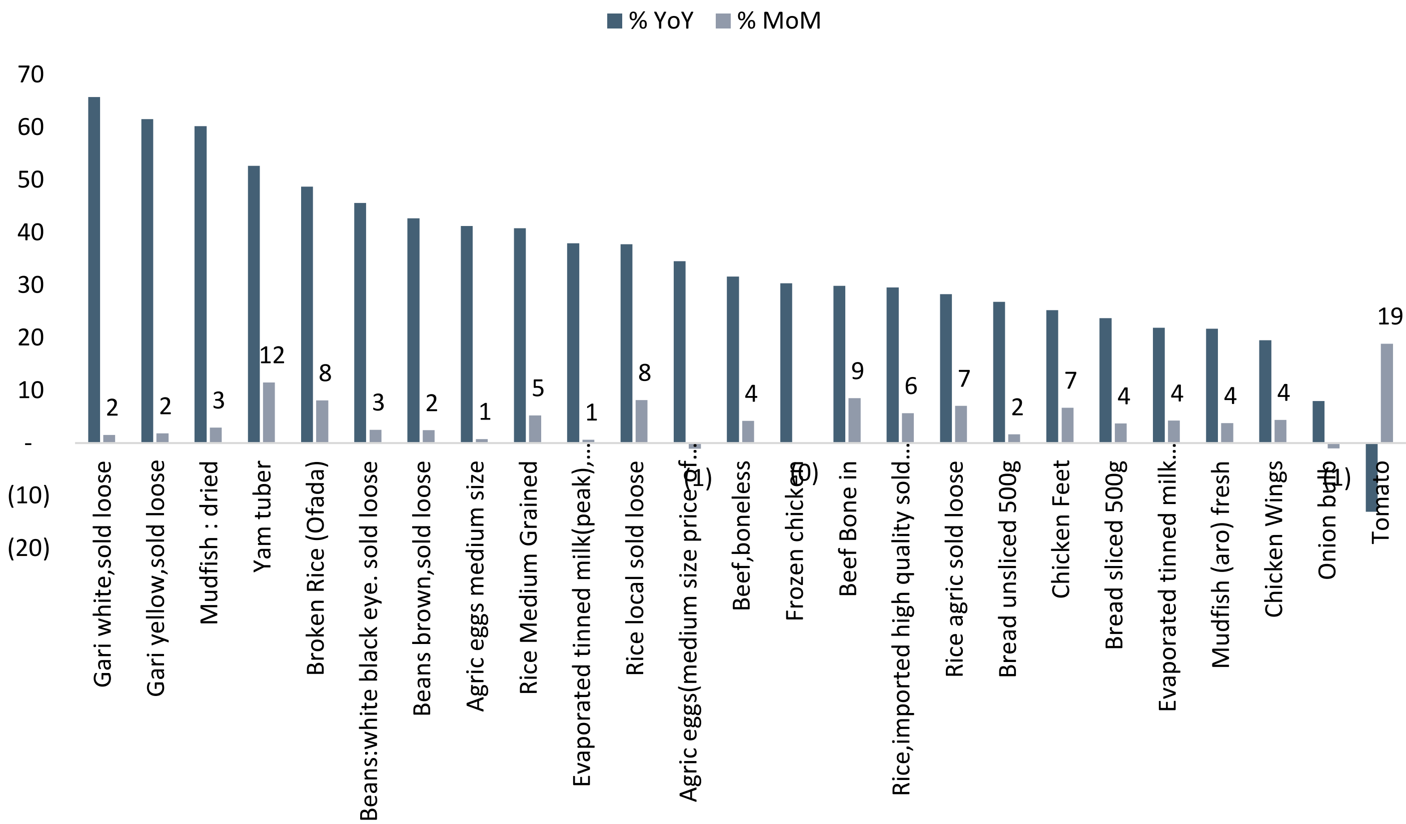
Specifically, transport inflation did not only fail to moderate in the review period, it touched its highest level in 9 months in May (+1.2% MoM) despite reported decline in diesel prices (-5.7% MoM to ₦216.30). The pressure from transport largely reflects follow-through from recent price hikes by major transport associations across the country in response to the sharp jump in Diesel prices in December. However, the recent MoM decline in diesel prices and subdued growth in PMS and cooking gas prices suggest that ongoing reforms are gradually gaining grounds despite current stickiness of transport cost. Away from the strain from higher transport cost, increased demand for cereals—especially in the predominantly Muslim north—in the bloom of the Ramadan season also added another dimension to the Nigerian food price challenge in May.

**Figure 1: Trend in MoM Core and Food Inflation**




Source: NBS, ARM Research

**Figure 2: Changes in selected food prices over May 2017**




Source: NBS, ARM Research

### *Base effect to bow out as food pressures dictate CPI tone*

Going forward, the continuation of the Ramadan season should leave pressures on cereal prices largely intact. Thus, aided by still elevated transportation cost which have limited gains from an appreciating naira, we remain bearish on food inflation despite ongoing green harvest in the Southern part of the country. That said, the cumulative benefits of sustained FX policy gains appear to have finally caught up with energy prices given subdued MoM growth in prices of PMS and cooking gas as well as decline in diesel prices in recent readings. We expect this to lead to a moderation in monthly core inflation reading in June—albeit expected to have a relatively pale influence on YoY reading compared to that from the just ended high base effect from 2016. Overall, our expectations across the core and food inflation buckets should translate to an unchanged headline reading of 16.25% YoY in June 2017.

In terms of market impact, the CBN is expected to maintain its ongoing foreign exchange management policy in line with its guidance at the last MPC. Specifically, putting subsisting food inflation pressures side by side with the positives from the newly introduced FX window for Investors and Exporters thus far, the CBN is unlikely to be in a hurry to exit its ongoing tight monetary policy and FX market drives. In any case, evidence from last GDP report reveals that the economy is already well on its way to recovery. In the near term therefore, we expect the CBN to sustain its sizable FX supply and aggressive OMO issuances, with the liquidity sapping effect of the duo leaving short term interest rates elevated.

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