Fundamentals

20 May 2022

Macroeconomic update | Strategy | Nigeria

Still torrid price pressures

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IN BRIEF

- Nigeria's April inflation reading is at an eight-month high, compounded by global factors such as the global commodities price rally, supply chain dislocation, and the shift in global monetary policy.

- In comparison to urban centres, rural settlements are worse hit by the impact of prevailing global factors on commodity prices, underscoring the inefficacy of the country's poorly-targeted subsidy regime that is constituting a drain on its financial resources.

- The persistence and breadth of inflation pose downside risks for not just the Nigerian economy, but also the financial market, as global de-risking plays a spoilsport across markets amid stagflation fears.

- The latest inflation data is not just about food and energy price increases, but also about the outcomes of Nigeria's unorthodox monetary policy.

- With recent experiences from Turkey to draw from, the prospects of a pervasive inflationary pressure ahead would further undermine market confidence in the naira. This would spark speculative demand for foreign currencies as monetary policy settings are too loose to combat inflation risks.

- Certainly, the monetary policy committee will be left in a bind at next week's meeting following the recent political shake-up, which does not rub off well on the bank's key currency – i.e. credibility.

Consumer prices in Nigeria quickened for the third consecutive month in April 2022. As annual inflation printed at 16.8% y/y from 15.9% y/y in March 2022. Monthly figures also advanced on accelerated goods and services costs causing inflation to remain stubbornly high and widespread. While the annual inflation reading is at an eight-month high, the 90bps pace of increase is the fastest the country has recorded over a 70-month period – reflecting the impact of global factors such as the global commodities price rally, supply chain dislocation, and the shift in global monetary policy.

The persistence and breadth of inflation alongside a tightening cycle will typically cause both global stocks and bonds to struggle. As a result, Nigeria's Eurobond yields will move up as the yields on liquid G7 notes rise to new historic highs. Therefore, gold provides a smart hedge against the impending global market volatility.

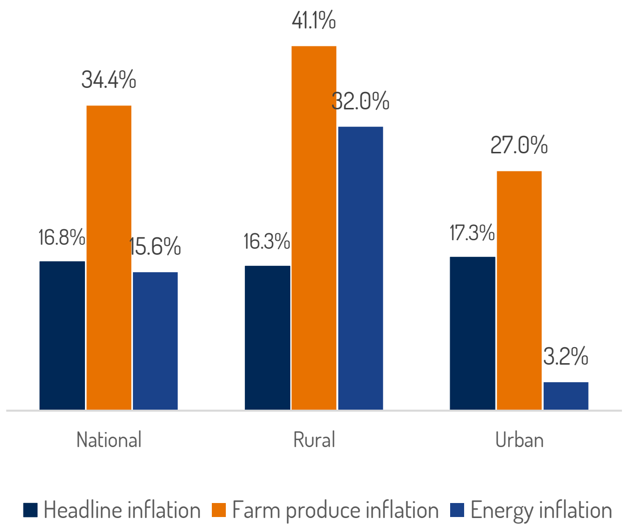
On the domestic front, persistently high rates of inflation will play a spoilsport as they are bad news for the local currency. As such, the prospects of a weaker naira – in the face of capital controls – will serve as a further deterrent to attracting foreign flows to the local debt market. Despite this, there could be room for opportunistic trades for local investors driven by the TINA (there is no alternative) effect and burgeoning pension assets.

How expensive are necessities in Nigeria?

Inflation in food and non-alcoholic beverages rose to 18.3% y/y from 17.2% y/y in March 2022. When food prices increase, there is bound to be a cascading effect on all other prices in the economy, making it more difficult to curtail. Nigeria's inflation has been running far too high and persistently so, due to a combination of rising food and energy prices that respectively make up 51.8% and 16.7% of the national consumer inflation basket. Excluding volatile food and energy prices, April's inflationary pressure was better and relatively muted from March at 14.1% y/y.

Rural settlements are worse hit by the impact of prevailing global factors on commodity prices, compared to urban centres. In rural areas, prices of farm produce and energy products – whose cultivation and distribution are being impaired by supply chain bottlenecks – rose by 41.1% y/y and 32.0% y/y respectively, compared to respective increases of 27% y/y and 3.2% y/y in urban areas.

National, rural, and urban inflation trends (%)



Source: Nigeria's National Bureau of Statistics (NBS)

This underscores the inefficacy of Nigeria's poorly-targeted subsidy regime that is not necessarily pro-poor but is constituting a drain on its financial resources. While the price of premium motor spirit (PMS) is being subsidised, the prices of other sources of energy – including kerosene which is widely used in rural areas – have seen their prices go up by an average of 73.3% YTD, as of April 2022.

Skyrocketing prices, a bane for the economy

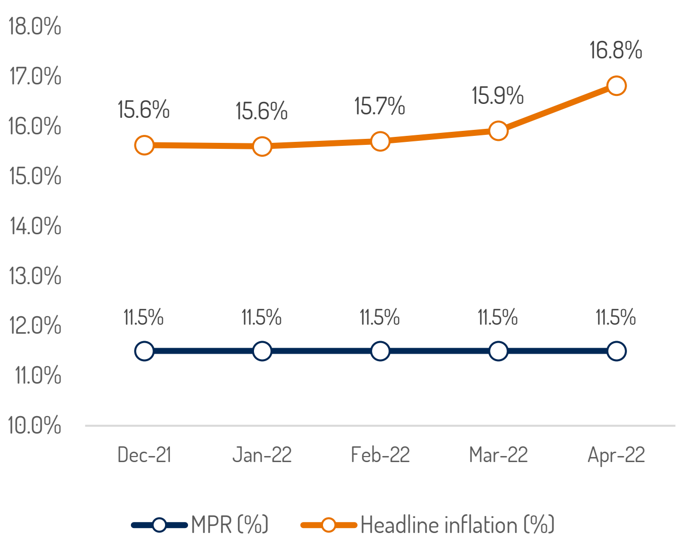
Nigeria's persistently running inflation continues to trigger concerns about its future economic prospects as households, businesses and, even the government continue to feel the squeeze of rising prices. As price pressures intensify, wages and business profits are not keeping up. A recent no-fly threat from the country's distressed local airlines was averted by the government's commitment to subsidize jet fuel for a three-month period, equally exacerbating pressure on already strained government finances. Also, a high inflation rate will worsen the exchange rate i.e. the naira is poised to lose some more value if the central bank does not act promptly.

The process of crushing inflation would involve some pain, but so would tolerating it.

With no indication of relief in sight, inflation is likely to remain a thorn in the flesh for Nigeria's policymakers. But there is only so much they can do to rein in prices without pulling the brakes on the economy. This would leave the monetary policy committee between the hammer and the anvil, as far as subduing inflation is concerned.

Should current price dynamics persist, it could compel a policy move beyond neutral and prompt the tightening of Nigeria's monetary policy. At the March meeting, four out of ten members voted in favour of a 25bps-50bps hike in the monetary policy rate (MPR) after five consecutive meetings of unanimous votes to hold monetary parameters constant. The change in voting pattern signals that rate hikes could be on the table in the coming months.

Nigeria's MPR vs headline inflation rates (%)



Source: Nigeria's National Bureau of Statistics (NBS), Central Bank of Nigeria (CBN)

However, further delay by the central bank to put the hammer on price spikes will cause foreign investors to continue staying away from Nigeria's financial markets because of reduced returns. This could lead to much stronger exchange rate pressures and even higher inflation.

The local bonds market can be a fickle mistress, as Eurobonds call the bets on the US Fed's tightening program.

In the context of elevated inflation and rate hikes, gold provides a smart hedge against market volatility. Nigeria's Eurobonds will be dealt a harsh blow by the US Fed's tightening program, while its local bonds will be a mixed bag in the face of financial repression. As the country's stagflationary environment persists, repressed bond yields will ensure negative real returns but a dearth of viable investment alternatives and burgeoning pension assets set the stage for opportunistic trades for local investors.

Conclusion

In a nutshell, we do not envisage a cooling of Nigeria's inflationary pressures any time soon and persistently hot inflation portends downside risks for Nigeria's economy and financial market. From a weaker local currency to the erosion of purchasing power, to the resulting stagflation from monetary tightening, and even the cost of inaction from monetary authorities.

Therefore, in a bid to uphold the central bank's institutional identity, Nigeria's monetary authority may prioritise saving the economy from the current inflation blight as sentiments continue to swing between inflation and economic growth. Although this could slow earlier growth prospects, the cost of monetary inaction is not less acute.

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