

FUNDAMENTALS

19 JULY 2022

NO RETREAT FROM SWELTERING INFLATION



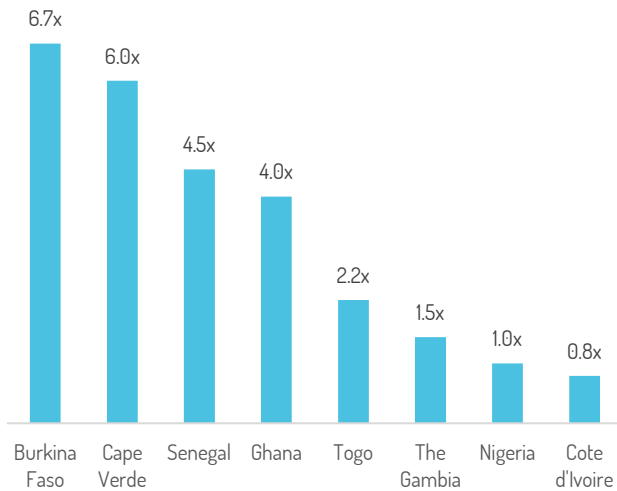
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IN BRIEF

- From the global economy, down to domestic economies, there is a nagging sentiment that something is just off - or it is about to be - making it difficult to feel good about anything, including the economy.
- Of course, the elephant in the room is inflation, which is unacceptably high and for most consumers, just incredibly annoying. The explosion of prices for everyday necessities has come as a shock to many.
- But every inflation is transient until the inflation boogeyman appears, and no country knows this better than Nigeria which is experiencing its longest double-digit inflation episode since 1995.
- Ghana has also been pushed to the brink by giddy double-digit inflation that has intensified since the onset of the Russia-Ukraine crisis - a development that has sparked tension and frustration across the country.
- Unfortunately, inflation has broadened beyond food and energy prices and now poses a clear and present danger.
- The human and economic impact of the war in Ukraine has worsened with commodity price shocks that have increased the cost of living for millions of West Africa's people, as prices are now rising at record rates.
- For many African states, the return of inflation is not just an important economic event, but also a political one as it becomes decreasingly plausible that it will simply fade painlessly away.
- If price stability is "the bedrock of the economy", in the words of the United States (US) Federal Reserve Bank (Fed) chair Jerome Powell, then tough decisions will have to be made by policymakers to tamp it down.

As in many parts of the world, including the United States (US), inflationary pressures in West Africa (WA) continue to intensify, leaving the subregion's people pinching pocketbooks and spooking local financial markets. In the majority of WA's countries, consumables cost multiples of what they cost one year ago.

DEGREE OF INFLATION COMPARED TO A YEAR AGO



SOURCE: BLOOMBERG

As the food and energy crisis precipitated by the European war continues to reverberate across the globe like ripples in a pond, WA's inflation blisters could worsen in the months ahead and prompt the region's central banks to step up the fight against inflation with economic growth as collateral damage.

Inflation continues to sizzle

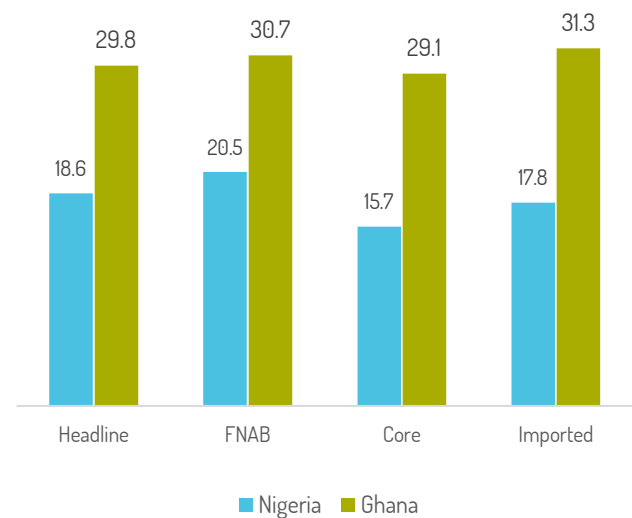
While Ghana may be experiencing a more severe threat to price stability at the moment as it turns to the International Monetary Fund (IMF) for support, Nigerians continue to grapple with a more-than-six-year-long double-digit inflation spell – the longest since 1995.

In Ghana, food (contributing 45.9%), transport (contributing 14.7%), and housing, water, electricity, and gas (HWEG – contributing 13.7%) were the major drivers of June's 29.8% y/y inflation print. Although food prices may have contributed the most to the annual inflation reading, non-food prices rose the fastest on a monthly basis (3.6% m/m) as elevated energy prices filtered into the cost of transport (5.1% m/m) and HWEG (4.9% m/m).

Nigeria's latest inflation snapshot showed that consumer prices rose by 18.6% y/y in June, amid its regressive petrol subsidy regime that has kept core inflation artificially low (15.7% y/y) – about half of the rate in Ghana. Also, inflation on food and non-alcoholic beverages (FNAB) in Nigeria was comparatively lower at 20.5% y/y (Ghana: 30.7% y/y), reflecting each country's degree of external strength.

While the price of cocoa was down by 4.1% y/y in June and gold up slightly by 1.4% y/y, the price of Brent crude was up 46.1% from a year ago. This translated into less pressure on the Naira relative to the Cedi, and fuelled a much higher rate of imported inflation in Ghana, compared to Nigeria.

KEY ANNUAL INFLATION TRENDS (%)

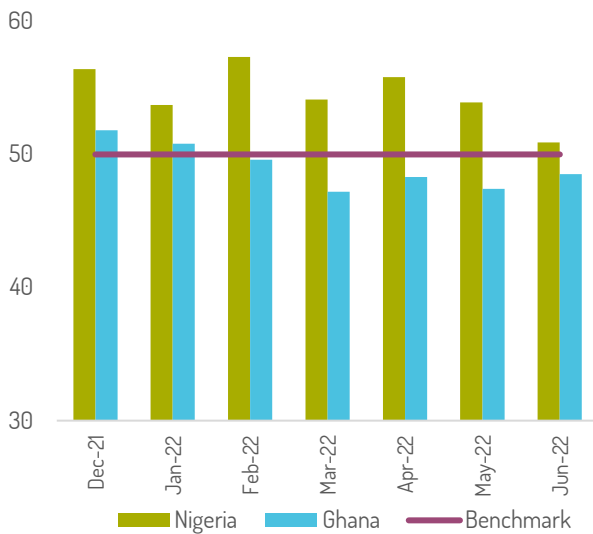


SOURCE: BLOOMBERG

Business confidence to sink on inflation, interest rate risk

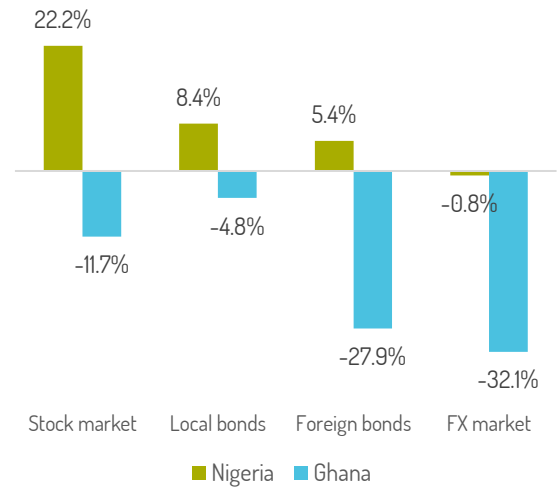
The high rates of inflation across the subregion will make people increasingly anxious about the economy, and the protracted European war will continue to unsettle public confidence in a safe and stable future – digging business confidence further into the pits. While Ghana's Purchasing Managers' Index (PMI) June reading by S&P Global posted below the neutral value of 50.0 for the fourth month in succession, Nigeria's reading slowed for the second consecutive month as the economic outlook continues to be darkened by inflation fears, and an unflagging pandemic that is denting optimism.

PURCHASING MANAGERS' INDEX TREND (YTD)



SOURCE: S&P GLOBAL

FINANCIAL MARKET PERFORMANCE (YTD)



SOURCE: BLOOMBERG S&P GLOBAL

The most pressing worry for many about the painfully high rate of inflation is the erosion of real incomes, as people are left to choose between digging deeper into their pockets or tightening their belts. Accelerating inflation is a vexing problem for central banks too as they are also tightening monetary policy to stem capital outflows and combat inflation – a move that could slow the breakneck pace of the recovery from the pandemic recession. Add social unrest and political dysfunction to the mix, and we have a noxious brew that will weigh heavily on the collective psyche for months to come.

Red-hot inflation, soaring US interest rates will spook financial markets

As soaring inflation is squeezing household budgets and pressuring central banks to raise interest rates, it will also be putting financial markets on the edge. In times of uncertainty, investors look for safety, prompting a dramatic reshuffling of investments from risky assets like equities, emerging market securities, and cryptocurrencies, to less risky, higher-yielding assets in developed markets.

Those moves could be more pronounced in countries like Ghana, where general economic concerns have been amplified by the multifaceted economic hits. However, unlike Ghanaian assets that are being hard hit by the global risk-off sentiment, the optimism for global oil demand that is keeping oil prices elevated could continue rubbing on sentiments for Nigerian assets.

Conclusion

As the shock waves from the European war continue to propel seismic shifts in commodity markets, it is pretty much a mathematical certainty that inflation rates in both Ghana and Nigeria will be higher in the months ahead rather than lower. While both countries may be fighting their respective battles with inflation, they are taking cues from what is happening in the world's largest economy – the US.

With the US Federal Reserve Bank (Fed) poised to deliver no less than a full-point rate hike at its July meeting, the potential ramifications for WA's heavyweights involve some gloomy possibilities. Therefore, it will be a difficult day in the office for the subregion's central bankers during the July meetings, as they try to build a bridge over the troubled waters.

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