

Economic Update

Nigeria's inflation rate eases to 11.90%

Composite CPI drops by 11.9% y/y... Nigeria's composite Consumer Price Index (CPI) declined by 11.9 per cent y/y in February compared to January 2012 (fig. 1). This is 70bps lower than the 12.6 per cent recorded in the previous month. The decline was attributed to the relative moderation in price increases between January and February as prices have been fully incorporated into producer costs. Seasonal adjustments also occurred in urban areas as prices fell in February after higher spending in December which usually pushes prices higher during that period. The monthly composite CPI was higher by 0.3 per cent when compared with January 2012 (fig.2). The increase in the headline index, composed of the core and food indices, was induced by increased prices of many food and non-food items revealing the effect of the partial removal of fuel subsidy. The biggest contributors to consumer inflation were the high prices of most food items, liquid and solid fuels, furniture and furnishings and transport fares.

... contrary to our – and general - expectation. Generally, there was general expectation that inflation rate will record a moderate increase and settle at about 15 per cent by the end of June 2012 going by the prevailing economic realities. This is in view of the direct impact of the partial removal of fuel subsidy on utilities, transport and food prices, which currently make up 16.7%, 6.5% and 50.7% of the CPI basket respectively, and as such would significantly drive inflation figure higher. Meanwhile, food inflation equally declined to 12.9 per cent y/y compared with 13.1 per cent in January whilst core inflation shed c. 157bps to 12.7 per cent against 14.3 per cent in January.

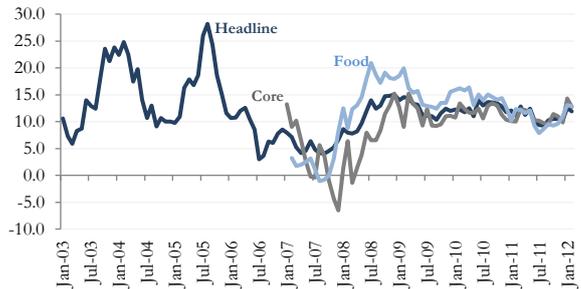
Is this a sustainable decline? Whilst the decline in the CPI is a positive development, it still raises significant concerns on its sustainability. There is a need to ascertain whether the decline in inflation is a blip or a trend. Therefore, we are inclined to highlight that a short term trend between May and August 2011, when inflation moved from 12.4 per cent to 9.3 per cent respectively and subsequently reversing to double-digit levels in December. Given current economic fundamentals, we are of the opinion that the decline in inflation rate may not be sustainable for now in view of the expansionary budget and proposed increment in electricity tariffs. Meanwhile, we note that real rate in the economy remains positive given that average yields on government bonds and treasuries are ahead of inflation by c. 226 and 250bps respectively. (fig. 3)

We maintain our position on interest rates. Against the backdrop of the current meeting of the MPC, we reiterate our position on the need for a low interest rate regime. Therefore, whilst we recommend a drop in the benchmark rate, we expect that, at the least, monetary authorities would hold the rate stable at 12 per cent whilst other measures are employed to address inflationary threats. Our position is informed by the need to grow the domestic bond market and providing appropriately-priced long term financing to the real sector and SMEs amongst other issues.

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Fig. 1: Nigeria: Headline, core and food inflation, y/y



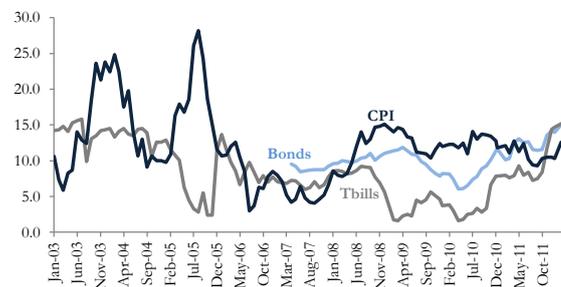
Source: DLM Research

Fig. 2: Nigeria: Inflation, y/y and m/m, 2008 - 2012



Source: DLM Research

Fig. 3: Nigeria: Inflation vs. bond & Tbilis yields



Source: DLM Research

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