February 2022 Inflation Flash

Headline Inflation rate reverses higher to print at 15.70%

United Capital
The Intelligent Choice

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Economics | Data Reaction

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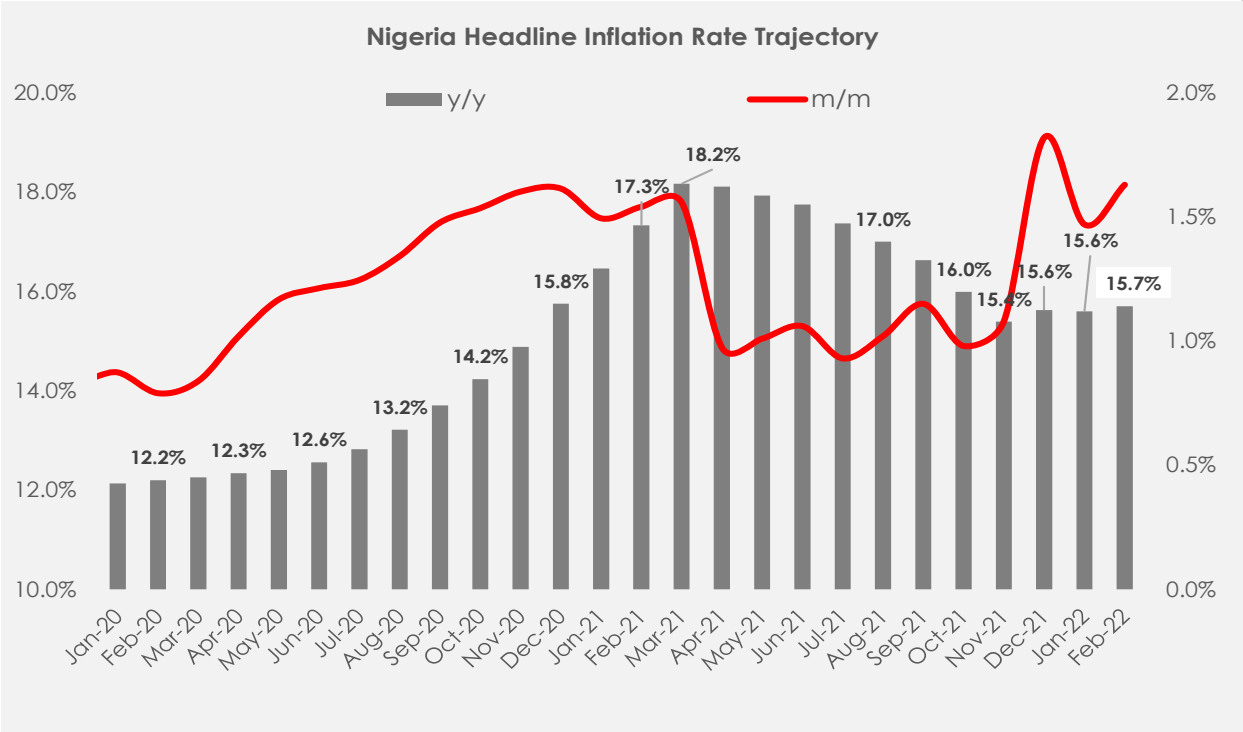
Food sub-index	core sub-index	Headline Index
17.1%	**14.0%**	**15.7%**

Yesterday, the National Bureau of Statistics (NBS) published the Consumer Price Index (CPI) report for Feb-22. According to the Bureau, the headline inflation climbed 10bps to settle at 15.7% y/y, from January's 15.6%. The increase in inflation came as a negative surprise as it printed ahead of our forecast of 15.3%, largely due to unforeseen circumstances that impact on price level during the month. On a m/m basis, the broad CPI increased by 16bps to print at 1.6%, higher than the 1.5% increase in Jan-22. At the time of our last update where we projected further decline in inflation rate, it was premised on expectations of softer food prices, high base effect and limited supply chain disruptions. However, since then, we have observed significant change in the price landscape as the Russia-Ukraine war triggered a surge in commodity prices while a prolonged fuel scarcity impacted on fuel costs and created unforeseen disruptions in the supply chain.



Sources: NBS, United Capital Research

Breaking the headline inflation into categories, food inflation moderated for the second consecutive month, printing lower by 2bps to settle at 17.1% y/y in Feb-2022. On a m/m basis, the food sub-index climbed to 1.9% in Feb-22, up 25bps from 1.6% in Jan-22. Given the

elevated m/m climb in the food sub-index, we believe the southward glide in y/y food inflation is a result of the Feb-2021 high base, as food prices were evidently pressured during the month. Legacy inhibitions to food supply such as unabating insecurity challenges, unfavourable weather conditions, low quality inputs and supply chain bottlenecks remain. Thus, despite the harvest period, food supply remains inadequate amidst sturdy demand. In addition, food prices with FX-linked pressures remained on the rise as FX concerns linger.

On the other hand, the core inflation sub-index rose to 14.0% in Feb-22, up by 14bps from 13.9% as of Jan-22. On a m/m basis, the sub-index climbed 8bps to settle at 1.3% in Feb-22. Clearly, the increase in inflation in Feb-22 was driven by uptick in the core sub-index. This increase was driven by inflationary pressures on the prices of Alcoholic Beverage & Tobacco, Utilities (Gas, Fuel, Electricity & Water), Clothing & Footwear, Education, and Recreation & Culture. The increase in price of alcoholic beverages was likely due to price increases implemented by beer & spirits producers due to raw material cost pressures. In addition, fuel scarcity and surge in crude oil price impacted on energy and fueling costs during the month, feeding uptick in the utilities basket.

Outlook: Upside risks for inflation become pronounced

Going forward, we expect to see sustained inflationary pressure, with headline consumer price index expected to climb faster in the coming months. First, the escalating geopolitical conflict in Eastern Europe is a key concern for inflation heading into the year. A prolonged conflict is likely to lead to supply gaps in the commodities market, particularly for wheat, gas, and crude oil, both of which have significant impacts for Nigeria. In a situation where a diplomatic resolution fails, higher crude prices will likely continue to force price of gas and diesel (both of which are deregulated) higher. This is also likely to sustain upward pressure on production and logistics costs, forcing producers to possibly raise prices. Thus, this has significant upside risk for energy costs, transportation costs and a huge pass-through impact on food & other consumables. In addition, global inflationary pressures continue to persist which is likely to keep imported inflation elevated in Nigeria.

Notably, in the past weeks, we have observed further FX demand controls which has forced banks to reduce monthly cap on FX transactions carried out using Naira debit cards. The elevated crude oil price environment has led to higher subsidy payments, more than netting off gains recorded from higher crude prices. In addition, crude oil production continues to underwhelm, preventing Nigeria from reaping the benefits of higher crude prices in form of increased dollar inflows. As a result, we believe the CBN's arsenal to defend the naira is depleting rapidly. This is likely to force another round of devaluation within the next six to nine months if the situation persists. This represents a significant upside risk for inflation.

Overall, putting these factors together, we now expect inflation rate to begin to trend higher

through the year. Interestingly, we expect the pace of increase to pick up as the high base effect wars of totally by the end of Q1-22. For March, we project headline inflation will print at 15.9%, reflecting impact of higher energy costs, transportations costs as well as food price pressures.

Impact for monetary policy and the yield curve

With the inflationary environment projected to remain elevated in the coming months, we struggle to see how monetary policymakers can continue to ignore the narrative. In the first MPC meeting of the year, the committee stated it subscribes to the viewpoint that current inflationary pressures are caused by structural challenges, rather than excess monetary pressures. While we note that this is very true evidenced by food supply challenges and higher energy costs stemming from higher crude prices, we believe some of the pandemic monetary support and credit expansion policies in the past year has led to some monetary-driven inflation. Thus, the committee may be forced to implement at least a 50bps hike in its benchmark interest rate before the end of the year in bid to claw back some of the pandemic monetary support.

For debt market investors, real return continues to head deeper into negative territory as yield compression across the yield curve and higher inflation erodes investment value. However, with the sustained inflationary pressure, expectation of higher government borrowings (due to pressured revenue and implementation of the 2022 capex budget from April), and tighter liquidity dynamics from April through August, the yield curve is likely to reverse sharply from April. Thus, we believe exposure to long duration debt instruments should be reduced with a preference for short term instruments in bid to avoid mark-to-market losses.

Disclaimer

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