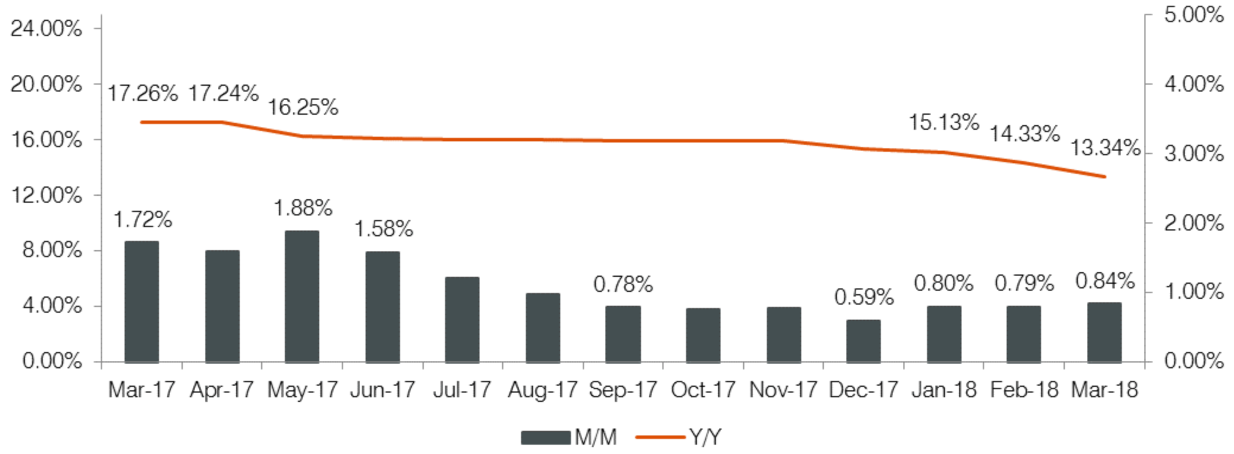
NIGERIA | MACRO | INFLATION

Last week, the Nigerian Bureau of Statistics released its inflation report for March 2018, which showed a moderation in headline inflation for the 14th consecutive month.

The Consumer Price Index fell to a two-year low of 13.34% year on year (y/y) in March 2018, from 14.33% y/y in February 2018, the largest reduction in headline inflation (-90bps) since May 2017. The March 2018 reading was largely in line with our estimate of 13.35% y/y for the month of March 2018.

Headline Inflation Performance



Source: NBS, Investment One Research

We highlight that the slowdown in headline inflation was mainly the result of the high base effect. This was more prominent on the Food sub-index, which fell to a 20-month low of 16.08% y/y in March 2018 after hitting an eight-year high of 20.32% y/y in September 2017.

Similarly, the Core sub index slowed down in March 2018 touching its two-year low of 11.18% y/y, 53 basis points lower than the figure in February 2018.

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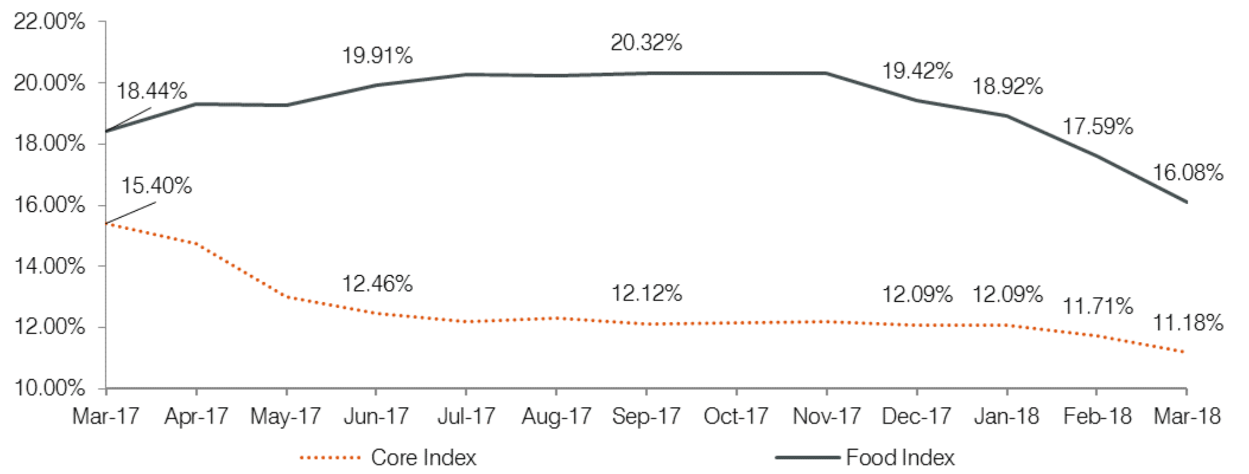
Core and Food Sub-index Performance



Source: NBS, Investment One Research

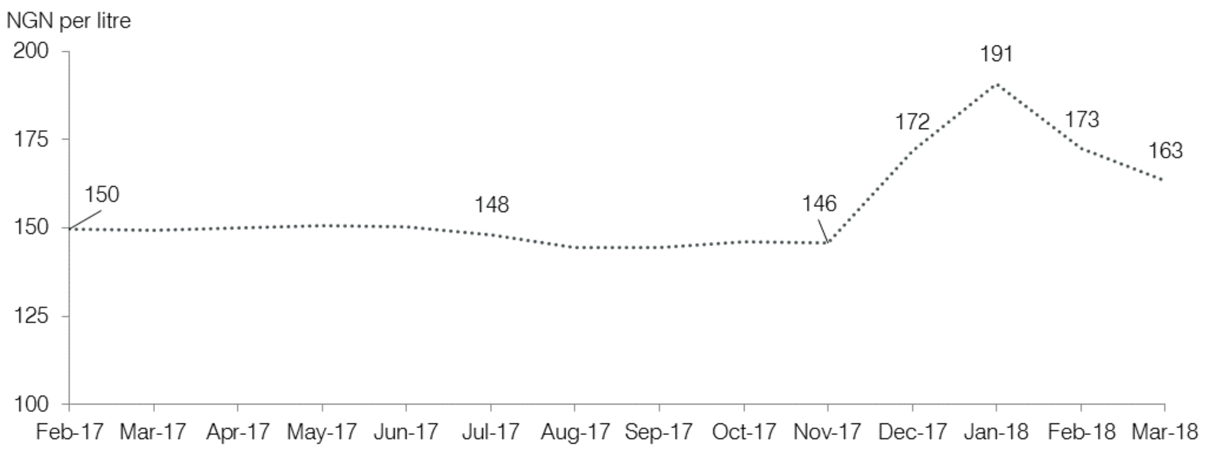
In our opinion, the significant drop in Food sub-index to a 20-month low may not be unconnected to the high base effect, which may be prominent till the end of August 2018. Similarly, we believe that the slowdown in Food sub index might have been supported by the early rainfall as highlighted by the President of Cocoa Association of Nigeria. This may continue to boost agricultural output in the coming months.

We believe the rise in average PMS Price paid by consumers, up 9.4% y/y to N163.40/litre in March 2018, though lower than February 2018 figure (N172.50/litre), might have hindered further downward movement in the headline inflation.

In addition to this, the rise in the transport index slowed to 11.91% y/y in March 2018, from 12.26% y/y in February 2018. This is might have been supported by the moderation in intra-city and inter-city fares, which increased by 26.05% y/y and 13.78% y/y in March 2018 to N160.99 and N1,668.56, against the 39.87% y/y and 25.23% y/y jump in February 2018 respectively.

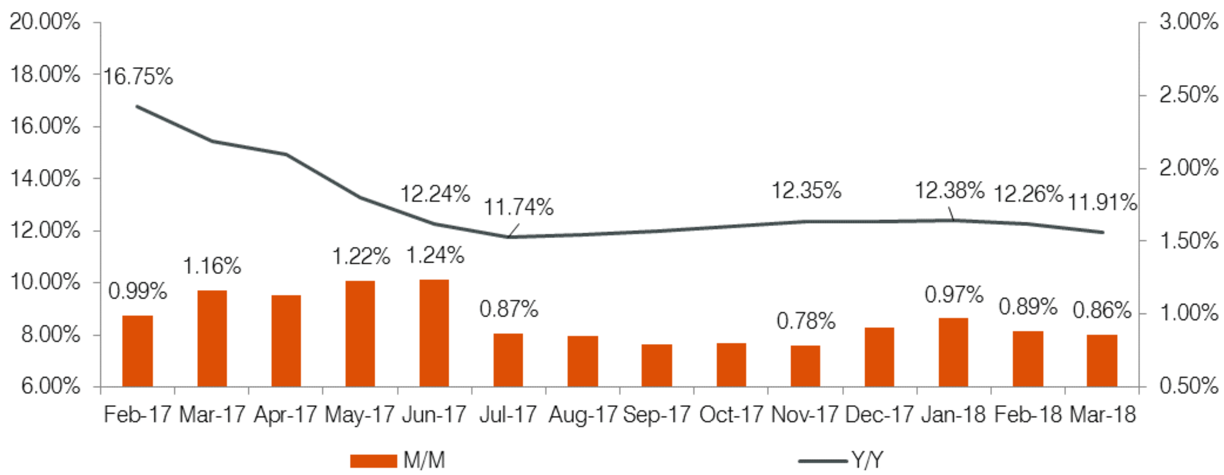
The moderation in the transported costs may also have contributed to the slower increase in headline inflation (y/y) given that the majority of the nation's goods and services are transported via road.

Average PMS Price Paid by Consumers



Source: NBS, Investment One Research

Transportation Sub-index Performance



Source: NBS, Investment One Research

However, we highlight that the base effect masked the rise in consumer prices as indicated by the month-on-month (m/m) movement in headline inflation.

Headline inflation increased by 0.84% in March 2018, from 0.79% in February 2018. Similarly, there was 5bps m/m increase in the Food sub-index to 0.90% and the Core sub-index inched up 9bps m/m to 0.84%.

Overall, the slow growth in Consumer Price Index is a reflection of the high base effects prominent in Food sub index, which has been supported by a slowdown in the rise of imported food prices (15.85% y/y in March 2018 against 16.09% y/y in February 2018) and Core sub index on the back of the stability in foreign exchange markets.

Implications

We believe the moderation in the increase in headline inflation may be a positive for consumer sentiment, corporate performances and economic activities.

Given our view that a slowdown in the increase of consumer prices could pave the way for the Central Bank of Nigeria to move to a more accommodative monetary policy.

Our opinion is premised on the fact that the CBN Governor highlighted that the Monetary Policy Committee (MPC) may reduce the benchmark interest rate from the currently level of 14.00% if inflation rate drops to closer to a single digit. Therefore, we may see the MPC reduce the Monetary Policy Rate by 100bps in H1 2018 to 13.00% in order to spur growth.

This as well as the Federal Government ‘s refinancing about N482billion worth of Treasury bills in Q2 2018, with proceeds from the recently issued USD2.5billion Eurobond, could see yields in the fixed income space decline in the near term.

The refinancing, which should lower the nation’s debt service to revenue ratio from c.45% could be a positive for the implementation of the proposed 2018 budget as the Federal Government may save about N91billion in 2018, according to the Minister of Finance.

Given the forecast for a further slide in inflation as well as interest rates, we could see investors (domestic and foreign) position for potential capital gains putting downward pressure on yields in the near term.

Nonetheless, expectation of a decrease in interest rate might be moderated by concerns regarding the US Federal Reserves' hawkish stance and the needs to attract foreign investor inflows in the defence of the local currency, particularly as we approach election year which may increase political risk.

Furthermore, the frequency of CBN's OMO auctions at 12.20% and 13.99% stop rates for 80-101day bills and 180-270day bills respectively could also limit the potential decline in yields in the fixed income space

Outlook

We maintain our view that the rate of increase in consumer prices in 2018 is likely to slow on the back of the high base effect, which may be more pronounced in the Food sub-index.

While the official price of PMS may be maintained at N145/litre, we point out that the continued scarcity of the commodity has seen the average price paid by consumer rise by about 9.4% y/y, though it fell by about 5.3% m/m, to N163.4/litre in March 2018. This poses a significant risk to the cost of transportation and consequently the outlook for inflation if the availability of the commodity does not increase in the near term.

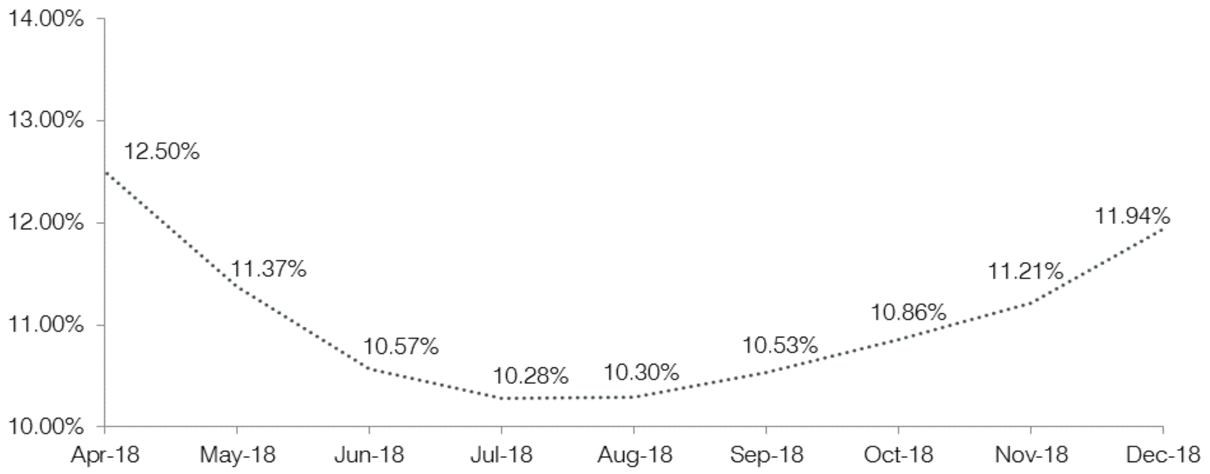
Despite the stability in the local currency, which should be supportive of imported inflation, the continued unrest in the North, which contributed to the slowdown in activities in the Agriculture sector in 2017, is still a challenge. This, as well as the lingering herdsmen attacks in different parts of the country, could pressure the Food sub-index in the near term.

However, we point out that early rainfall as highlighted by the President of Cocoa Association of Nigeria may improve agricultural output thereby supporting the decline in the Food sub index.

Furthermore, we highlight that the potential rise in minimum wage from N18,000 to N56,000 in Q3 2018 and election spending could put upward pressure on price levels in H2 2018.

Nonetheless, our inflation projection for April 2018 stands at 12.50% y/y and end of the year projection of 11.94%. Our end of the year estimate is in line with Central Bank of Nigeria's and Federal Government's targets of 11-12% and 12.40% respectively in the short term though still above CBN's long term target range of 6-9%.

Inflation Outlook



Source: NBS, Investment One Research

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