Economic note

16 June 2021

Favourable Base Effects to Further Moderate Headline CPI.

Inflation – May 2021

In our April inflation report (see report: A Transitory Moderation in Food Prices but Upside Risks Remain Elevated), we expressed that the year-on-year inflation rate will moderate given our expectation of a slower rise in food prices amidst a subdued growth in the core basket. True to our prognosis, the recently published data by the National Bureau of Statistics (NBS) showed that the headline inflation moderated for the second consecutive month to 17.93% y/y (April: 18.12% y/y). On a month-on-month basis, the headline inflation increased by 4bps to 1.01% m/m – tracking below the 2021 average of 1.32%. The outturn is 8bps lower than Cordros' estimate (18.01% y/y), with the deviation primarily seen from the core basket and 27bps lower than Bloomberg median consensus estimate (18.20% y/y).

After the positive surprise in April, food inflation resumed its uptrend in May in line with our expectation. For us, the increase in food prices was due to the combined impact of (1) resumption of food demand as the people depleted their Ramadan-induced food reserve, (2) limited supply of food produce to the market given the ongoing planting season and (3) pre-existing supply chain constraints. Accordingly, food inflation rose 1.05% m/m (April: 0.99% m/m). The breakdown provided showed that price increases across Processed food (+12bps) and Imported food (+1bp) were enough to offset the decline in the prices of Farm produce (-13bps).

Figure 1: Trend in Food Inflation Basket (m/m)

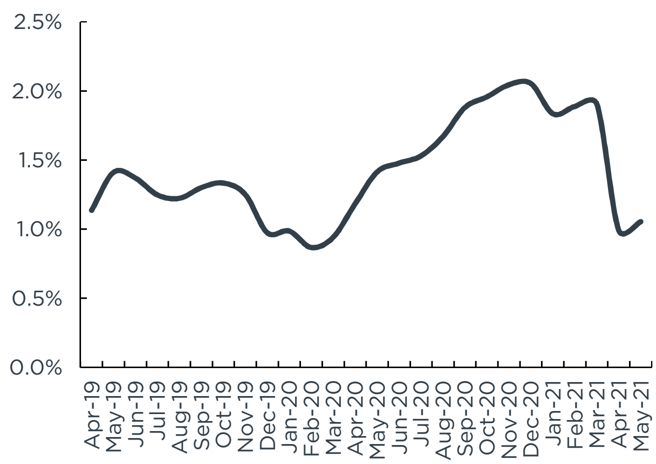
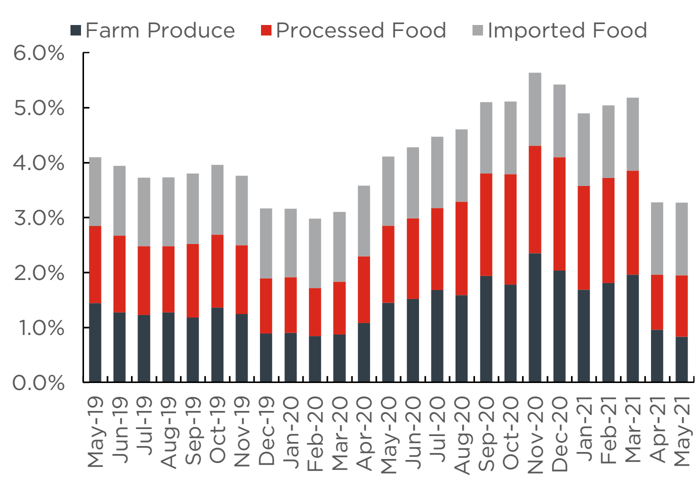


Figure 2: Trend in Food Inflation Sub-Components (m/m)



Source: NBS, Cordros Research

Given the favourable base from the prior year, food inflation moderated by 44bps to 22.28% y/y, driven by the Farm produce (-74bps) and Processed food (-36bps) baskets, both of which masked an increase in the prices of imported foods (+8bps).

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Elsewhere, core inflation increased by 42bps to 13.15% y/y in May (April: 12.73% y/y). We believe the preceding reflects the (1) increase in PMS (+27.2% y/y) and diesel prices (+5.8% y/y) and (2) increased demand for transport services that accompanied the enhanced movement of people compared to a year ago. On a month-on-month basis, the core inflation masked a three consecutive month of decline as it increased by 25bps to 1.24% m/m – the highest in four months. We observed marginal prices increases across the Processed food (+12bps), Education (+3bps), Restaurants & hotels (+3bps) and HWEGF (+1bp) components.

Figure 3: Trend in the Core Inflation Basket (m/m)

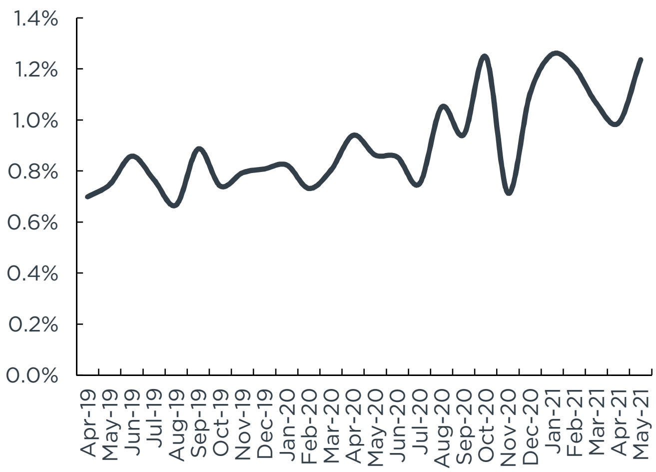
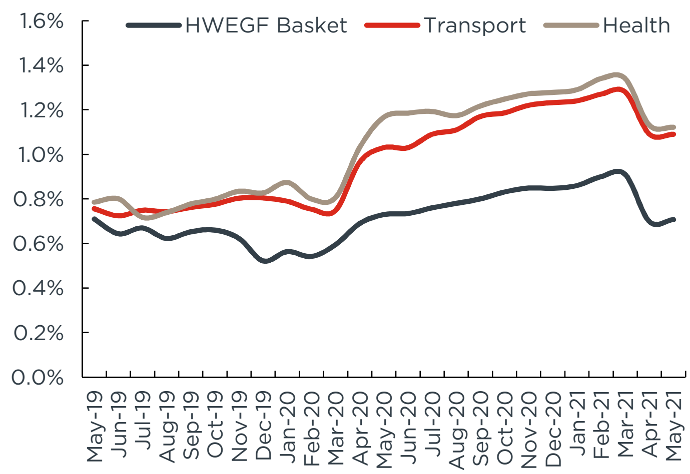


Figure 4: Core Inflation Sub-Components (m/m)



Source: NBS, Cordros Research

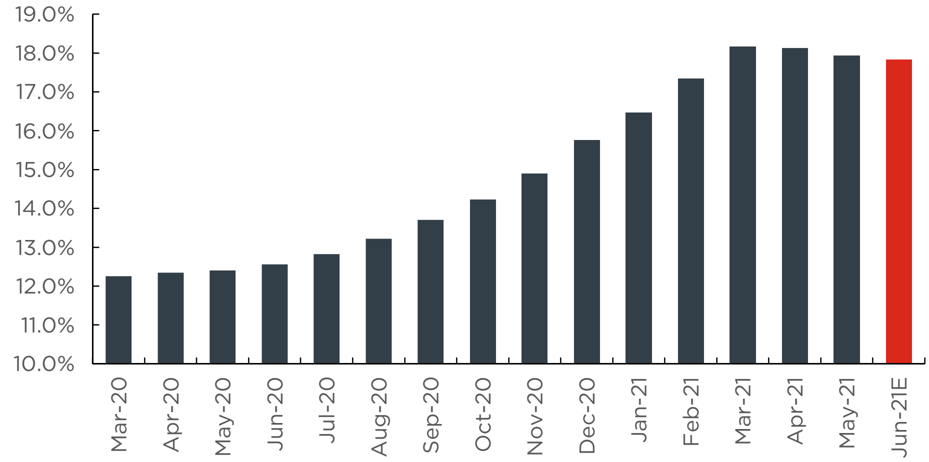
Outlook: High Base Effect to Drive CPI Downwards despite Structural Constraints

Although off-season harvest in the country's northern parts is still in place, we believe the confluence of (1) the ongoing planting season across the country and (2) the rainy season in the southern parts of the country would keep food prices elevated in the current month. In addition, the pre-existing structural challenges such as persistent insecurity and disruption to trade flows amid weak infrastructure are expected to put upward pressure on food prices. **Accordingly, we expect food prices to increase by 1.06% m/m in June, translating to a y/y reading of 21.76%.**

We understand that despite the Nigeria Governors' Forum (NGF) recommendation that retail fuel prices should be sold between NGN385.50/litre and NGN405.00/litre, NNPC has maintained that fuel prices will continue to trade around NGN162.00/litre pending the time FG concludes its meeting with labour organizations. Meanwhile, increased speculations has led to a depreciation in the parallel market exchange rate, just after the CBN's convergence of the official and NAFEX rates in the last week of May. We expect the preceding to impact the core inflation given the sizable FX demand in the parallel market space and its attendant impact on durable goods. **Consequently, we project that core inflation will increase by 1.15% m/m in June.**

Overall, we expect the headline inflation to increase by 12bps to 1.13% m/m, with the favourable base effect from the prior year translating to a y/y print of 17.83%.

Figure 5: Headline Inflation – Historical and Forecast (y/y)



Source: NBS, Cordros Research Estimates

Disclosures.

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