Macroeconomic Snapshot:

Unraveling the Price Puzzle

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Bird's Eye View

Inflation Rate.

Inflation increased from 22.41% in May 2023 to 33.95% in May 2024.

Headline inflation printed 33.95%, Food Inflation at 40.66% in May, 2024 Y-O-Y.

High Misery Index

Exchange Rate.

Official exchange rate depreciated by almost 200% from ₦461.1/$ in May 2023 to ₦1,433.8/$ in May 2024 on the back of CBN policy actions on Unification and Liberalization Exercise.

Real GDP Rate.

GDP grew by 2.98% in Q1 2024 compared to 2.31% recorded in Q1 2023 Y-O-Y. On Q-O-Q fell from 3.46% in Q4 2023.

Monetary Policy Rate

Tighter monetary policy stance - MPR raised by 750 basis points to 26.25%

Overview

As Nigerians grapple with soaring inflation alongside the plummeting local currency the Naira, households, firms, and Policymakers seek the magic wand to neutralize the adverse effect of the all-time high, multifaceted, and syndicated inflation levels. As termed by the International Monetary Fund (IMF), Inflation is the rate of price increases over a given period. Inflation is typically a broad measure, such as the overall price increase or cost of living over time in a Country. The persistent and sustained growth in the general prices continued to catapult higher becoming the most significant challenge for Nigerian households and businesses, exacerbating the impact on the cost of living, eroding the purchasing power, and knocking down to the state of poverty and uncertainty in routine economic decision-making.

Despite the current tide of inflation being on a steady upward trend, it cannot be unconnected to the graduated impact of the composite of the Cash crunch emanating from the Currency redesign exercise, election season, excess money supply, flooding, and, Insecurity all from 2023. However, the combined effect of Fuel, energy subsidy removal (electricity tariff hike) and, the exchange rate/ unification exercise have accelerated the magnitude at which inflation is drifting. The decade-long fuel subsidy removal debate cut across the intersection between political will and economics, despite being a necessary Fiscal imperative was sub-optimally implemented given that no substantial buffers were put in place to cushion the impact on livelihood, transportation, household, and business routine expenditures. Similarly, the foreign exchange reform has led to a record-high depreciation of the naira alongside accompanied illiquidity which has hampered individuals and businesses who rely on foreign currencies for cross-border transactions. The reform was adopted with the end goal of closing /bridging the widening gap between the official and parallel market premium to an acceptable threshold (Premium) and ensuring stable liquidity and fair pricing in the foreign exchange market.

The collective cobra effect of both Policy stances has triggered well-perceived unintended consequences that precipitated the plunge in household disposable income, exchange rate volatility, elevated inflation levels, and economic uncertainty. The latest National Bureau of Statistics (NBS) CPI report for May 2024, printed the headline inflation to 33.95% slightly higher than 33.69% in April 2024. As compared with May 2023 the Y-O-Y stood at an 11.54% increase, conversely, the M-O-M inflation reveals a deceleration at 2.14% which was 0.15% lower than the rate recorded in April 2024 (2.29%).

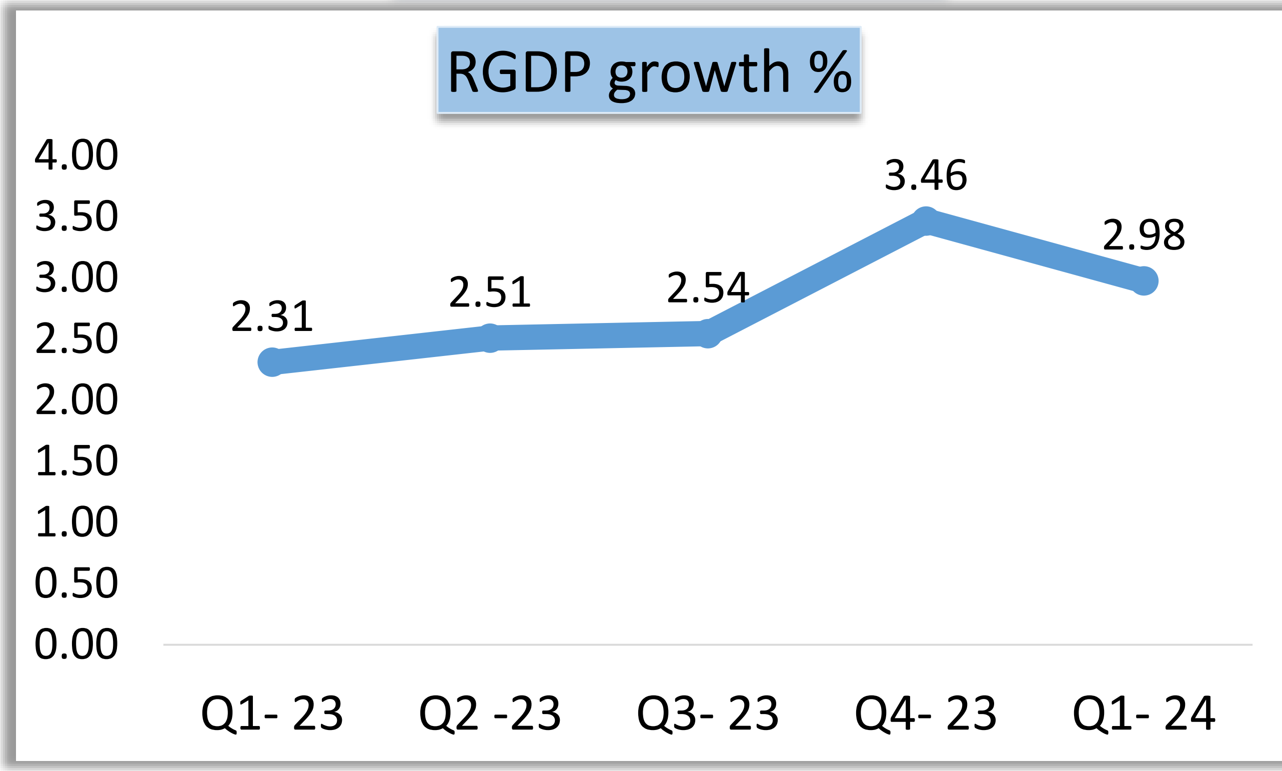
Macroeconomic Parameters

As the steady recovery from the periods of economic boom and burst in the aftermath of the 2007/2008 global financial crisis and COVID-19 Pandemic shocks continues, Nigeria's annual Real GDP grew by 2.74% in 2023 compared with 3.10% in 2022. Nigeria's economy grew by 2.98% (Y-O-Y) in real terms in the first quarter of 2024. This growth rate is higher than the 2.31% recorded in the first quarter of 2023 and lower than the fourth quarter of 2023 growth of 3.46%. Output growth during the review period was driven largely by non-oil production, particularly services and agriculture, contributing to 58% and 21%, respectively. The current growth trajectory is significantly lower than President Tinubu's vision of achieving annual growth of 6% and $1 trillion economy by 2030.

Table 1

s/n	Parameter	Value
I	RGDP %	2.98%
II	Inflation	33.95%
III	MPR	26.25%
IV	Exchange Rate	₦1485.53
V	Money Supply (M3)	N96,974,201.5million
VI	Oil Production	1.57 mbpd

Figure 1



Source –; NBS, CBN; FMDQ Researcher's Computation Computation

Theoretical Insights

Cost- Push Inflation; The reduction in the aggregate supply of goods and services as a result of an increase in the cost of production. This means the spillover from the dynamics in the production function has a pass-through effect on the final price of final goods and services. The pass-through distorts the production capacity, availability of goods and services, and profit margins of industries. The dynamics might be in the form of a hike in feedstock prices, a rise in labor cost (wages/salaries), cost of imports, higher energy cost, and an increase in tax rates by the government.

Demand-pull; refers to an increase in aggregate demand driven by the combined sectors of the economy: households, businesses, government, and the foreign sector. This results in excessive demand for the limited quantity of goods and services, leading to heightened competition and higher bid prices, often described as "too much money chasing few goods." The surge in demand can be attributed to various factors including increased government spending, excess money supply, fiscal stimulus, local currency depreciation, and tax cuts.

Stagflation; Stagflation is a term used to describe an economic cycle in which there is slow growth, high unemployment, and inflation happening simultaneously. This can be particularly challenging for policymakers because trying to address one issue can worsen another.

Philipps Curve; The Phillips curve postulates an economic theory that suggests an inverse and stable relationship between inflation and unemployment, meaning that higher inflation rates are correlated with lower unemployment, and vice versa. However, the stable trade-off between inflation and unemployment ceased to hold in the 1970s with the emergence of stagflation, which cast doubt on the credibility of the Phillips curve.

$$\pi_t = \alpha_1\pi_{t-1} + (1-\alpha)\,\mathrm{E}\{\pi_{t+1}\} + \alpha_2 rmc_t + \varepsilon_t$$

$$rmc_t = \alpha_3\,\hat{Y}_t + (1-\alpha_3)\hat{Z}_t$$

In macroeconomic modelling, the Philipp's Curve demonstrates how Manufacturers reset Prices based on previous inflation, rational expectations and marginal cost as approximated by the Real Marginal Cost (RMC). The real marginal cost index is a composite of the output gap and the exchange rate gap. The output gap here reflects the impact of increased aggregate demand for output, whilst the exchange gap measures the marginal cost associated with increased local currency depreciation.

Inflation continued its upward drifting, Prints 33.95% Y-0-Y

The compounded adverse effect of fuel subsidy removal, electricity hike, and sustained exchange rate depreciation alongside a host of structural and fundamental inefficiencies have continued to trigger the spike in the inflation rate. Nigeria's headline inflation rate accelerated to **33.95%**, marking the highest reading since March 1996. This surge came amid a further rise in fuel prices after the government removed subsidies and currency weakness. Food inflation, which accounts for the bulk of Nigeria's inflation basket, reached **40.66%** in May, driven by increased prices of potatoes, fish, and meat.

Figure 2

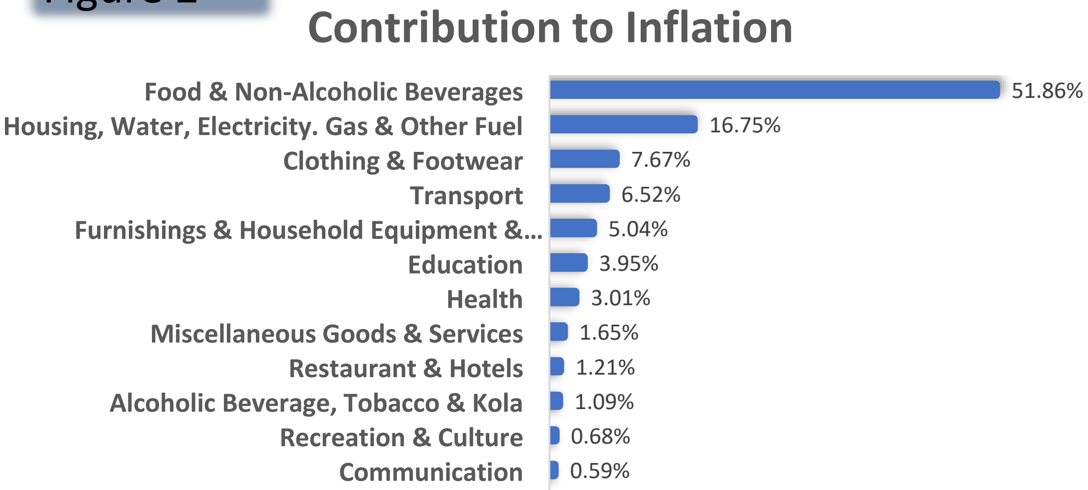
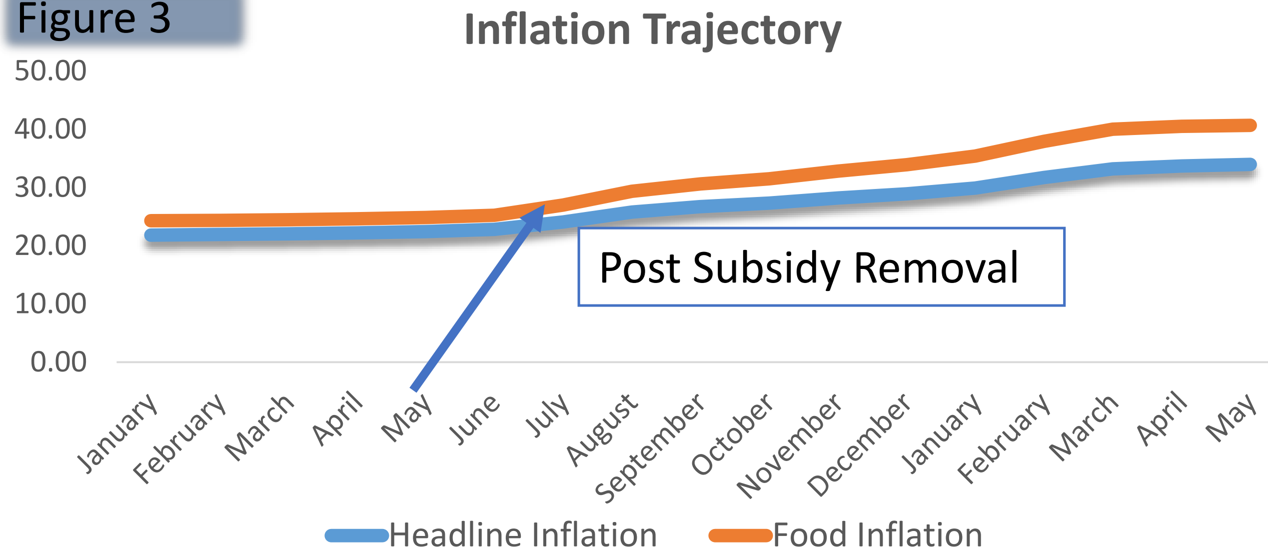


Figure 3



Source: NBS, Researcher's Computation

- Food Inflation remains the main driver of Inflation at 51%.
- Food Inflations spike attributed to the near collapse of the national food system, logistics and transport.
- Also, hike in cost of inputs, lingering Insurgency, impacts of climate change and increase speculative activities at the middle of the agricultural value chain.
- Weak disposable income, constrained aggregate demand.
- Sachetization and shrinkflation in consumer goods and disruption of firm's mark-up functions and revenue projections.
- Impact on real returns on assets and investment portfolios.

Time Value of Money; Purchasing Power dipped by four-fold over the decade.

Table 2

Year	CPI	Equivalent of ₦10,000
2014	157.4	46,592.92
2015	171.6	42,744.57
2016	198.3	36,983.54
2017	230.5	31,813.42
2018	257.3	28,504.65
2019	286.6	25,588.48
2020	322.2	22,764.69
2021	379.9	19,303.06
2022	447.2	16,398.58
2023	547.5	13,396.06
2024	733.4	10,000.00

Source: NBS, Researcher’s Computation

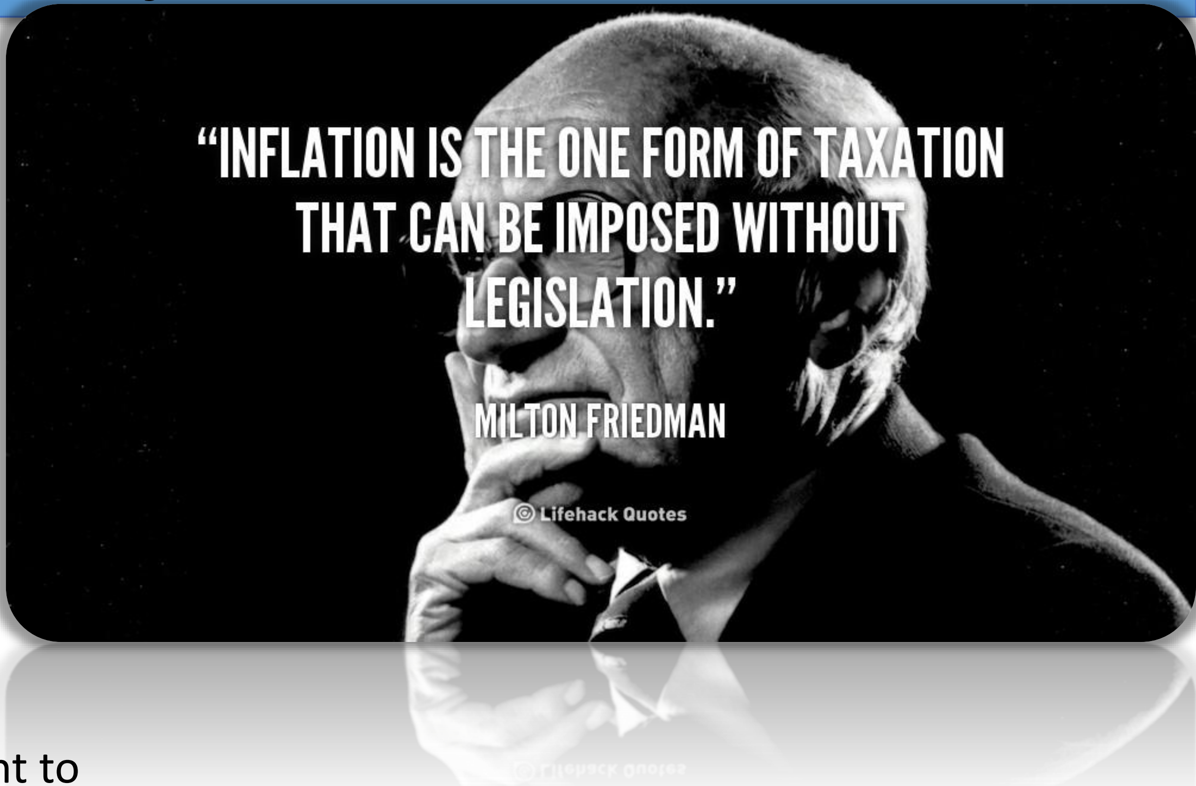
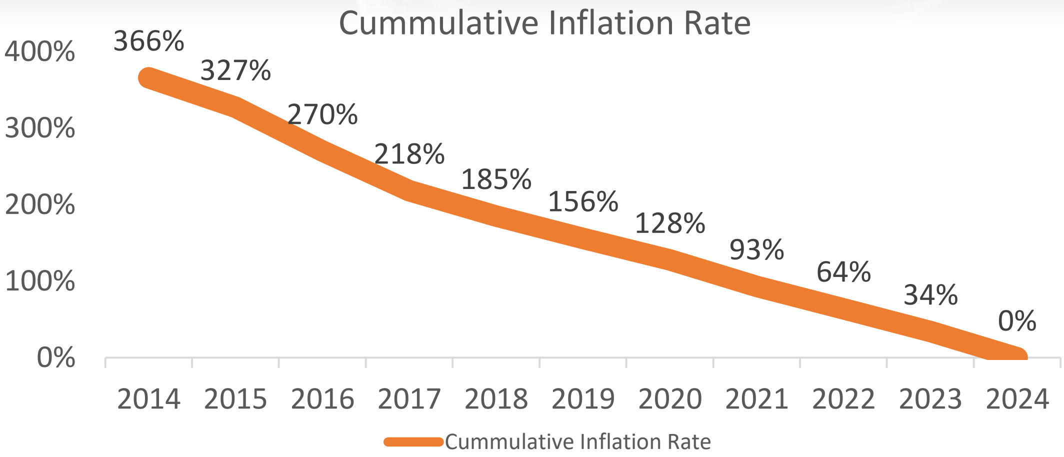


Figure 4

- Using May 2014, as a base year, ₦10,000 in 2014, is now equivalent to ₦46,592 in May 2024.
- A household needs a lump sum of ₦46,592 in today’s economy to purchase the same quantity/basket of goods bought at ₦10,000 in 2014.
- Over the decade, the cumulative inflation rate stands at 366%.



Monetary Policy: A Drift Back into Orthodox Strategies.

Upon taking over the mantle, the new CBN management pledged to return back to orthodox approach to monetary policy as opposed to Heterodox tactics, also expressed a pragmatic impression of Inflation hawks, thereby favoring Inflation targeting over other alternative frameworks, such as Exchange Rate targeting, Monetary targeting, Interest Rate targeting, etc. Cumulatively, to counter the inflationary trend, the CBN hiked the Monetary Policy Rate (MPR) by 750bps from 18.75% to 26.25%.

The Price puzzle in the economics literature is an empirical phenomenon observed when an unexpected monetary tightening occurs (often indicated by a positive shock to the policy rate), it leads to a counterintuitive increase in inflation in the impulse response function. Essentially, the price level rises persistently despite the contractionary monetary policy action. However, With the recent developments in the Nigerian economic landscape, there has been a consistent decline in the month-on-month inflation rate for three consecutive months. However, it is premature to attribute this decline solely to the increases in the MPR. In Nigeria, drivers of inflation encompass non-monetary factors, indicating that relying solely on monetary policy actions may not be adequate. While the growth-inflation trade-off is at stake, the rate hikes have resulted in higher interest rates and yields on fixed income instruments.

Figure 5

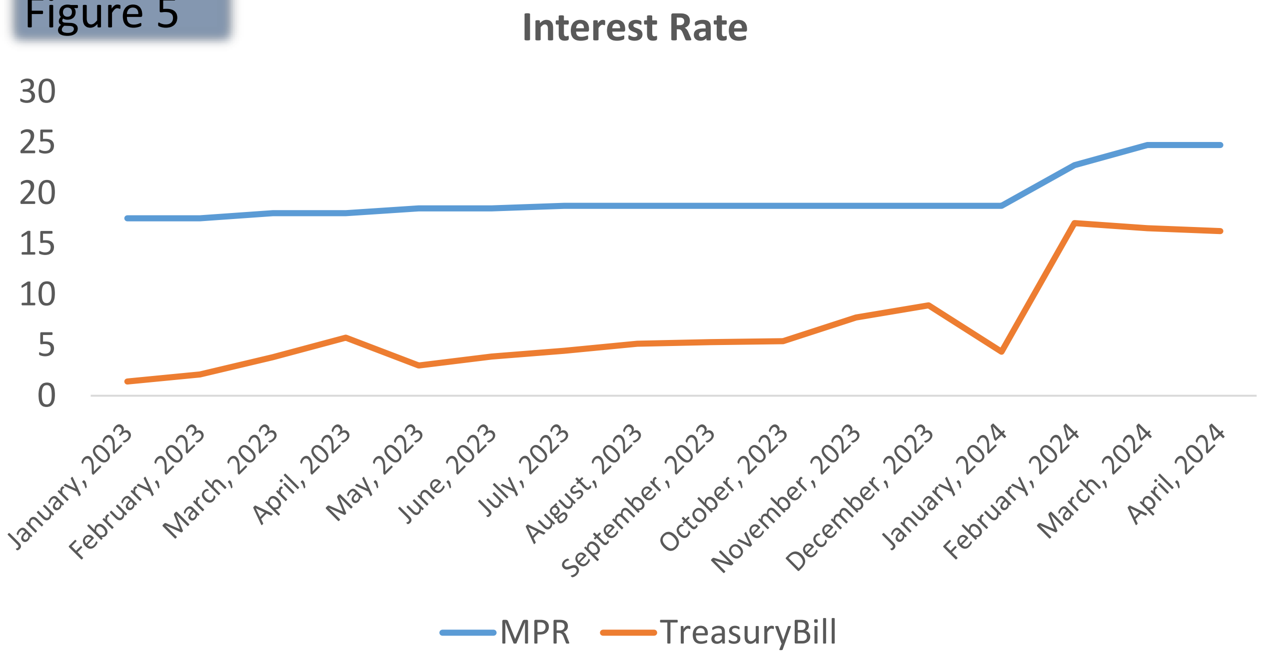
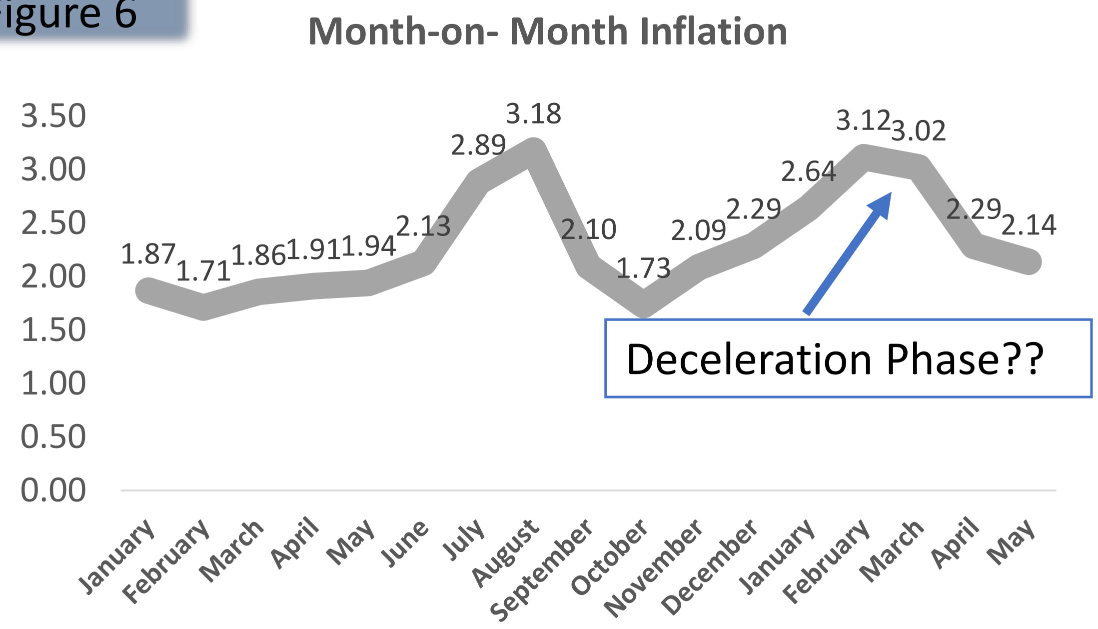


Figure 6



Source –; CBN; Researcher's Computation Computation

Recent Developments in Monetary Policy

Table 3

S/N	Parameters	Policy Parameters		
		1st Meeting	**2nd Meeting**	**3rd Meeting**
1	Monetary Policy Rate (MPR)	Raised the MPR by 400 basis points from 18.75% to 22.75%	Raised the MPR by 200 basis points from 22.75% to 24.75	Raised the MPR by 150 basis points from 24.75% to 26.25%.
2	Asymmetric Corridor	Asymmetric corridor around the MPR adjusted to +100/-700 from +100/-300 basis points.	Reversed the asymmetric corridor to +100/-300.	Retained the asymmetric corridor at +100/-300
3	Cash Reserve Ratio (CRR)	Raised the CRR of commercial banks from 32.5% to 45.0%.	Raised the CRR of merchant banks from 10% to 14%.	Retained the CRR of commercial banks at 45% and merchant banks at 14%
4	Liquidity Ratio	Retained the Liquidity Ratio at 30%	Retained the Liquidity Ratio at 30%	Retained the Liquidity Ratio at 30%

Source: CBN

Inflation Initiatives

- Adoption of Inflation Targeting Framework
- Tighter monetary policy stance - MPR raised by 750 basis points to 26.25%
- CRR adjusted to 45% from 32.5%
- Asymmetric corridor around the MPR adjusted to +100/-700 from +100/-300 basis points.

Exchange Rate Initiatives

- Unification of Exchange Rates window
- Liberalisation; Willing buyer/Willing Seller FX market
- Clearing of FX backlog obligations to banks and Airlines
- Ceiling on banks Net Open Position
- Lifted the daily cap of N2 billion on remunerable Standing Deposit Facility (SDF)
- Ongoing BDCs Reform Exercise

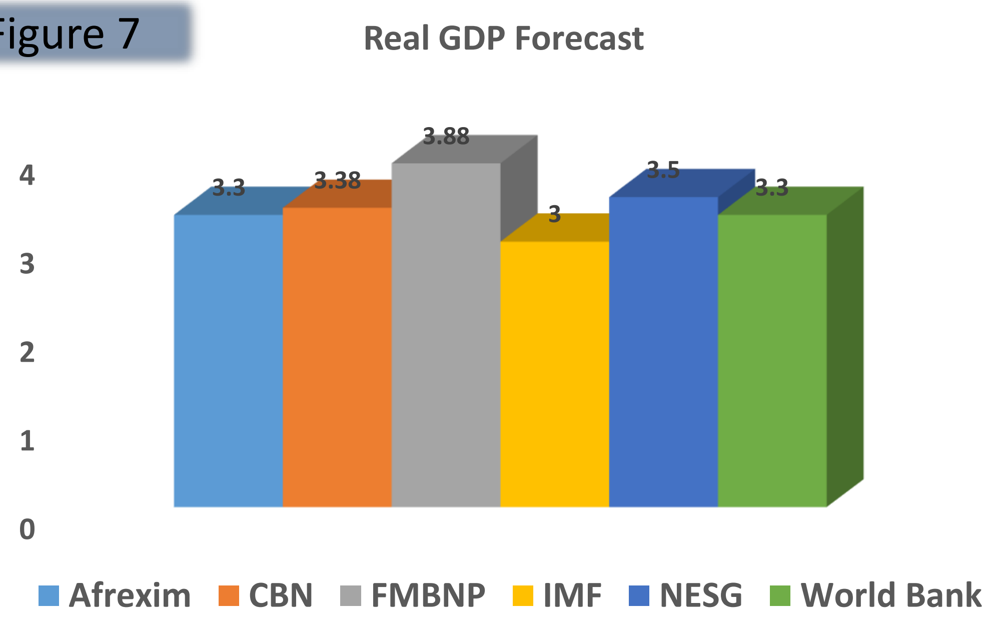
Action Priority Matrix

OUTLOOK

Table 4

	High Effort	Low Effort
High Impact	• Education System Overhaul • Healthcare System Strengthening • Infrastructure Development • Power Sector Reform • Fiscal Policy and Tax Reform • Fortified National Security • Transport Network Expansion • Renewable Energy Investment	• Digital Economy Promotion • Agricultural Value Chain Improvement • Social Security Systems • Sports and Recreation Development
Low Impact	• Public Sector Reform • Industrial Diversification • Urban Planning and Development	• Tourism Promotion • Arts and Entertainment • Sports and Recreation Development

Figure 7



Source: Afrexim, CBN, FMBNP,IMF, NESG, World Bank

Key Takeaways :

1.Focus on Quick Wins: Implementing policies to promote the digital economy and improve the agricultural value chain can yield quick benefits.

2.Prioritize Major Projects: Long-term projects like infrastructure development and power sector reform are critical for sustained growth.

3.Simplify Systems: Streamlining the tax system and promoting tourism can provide moderate benefits with relatively low effort.

4.Plan for the Future: Despite being challenging, reforms in the public sector and industrial diversification are essential for long-term resilience and diversification of the economy.

Contact Details

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