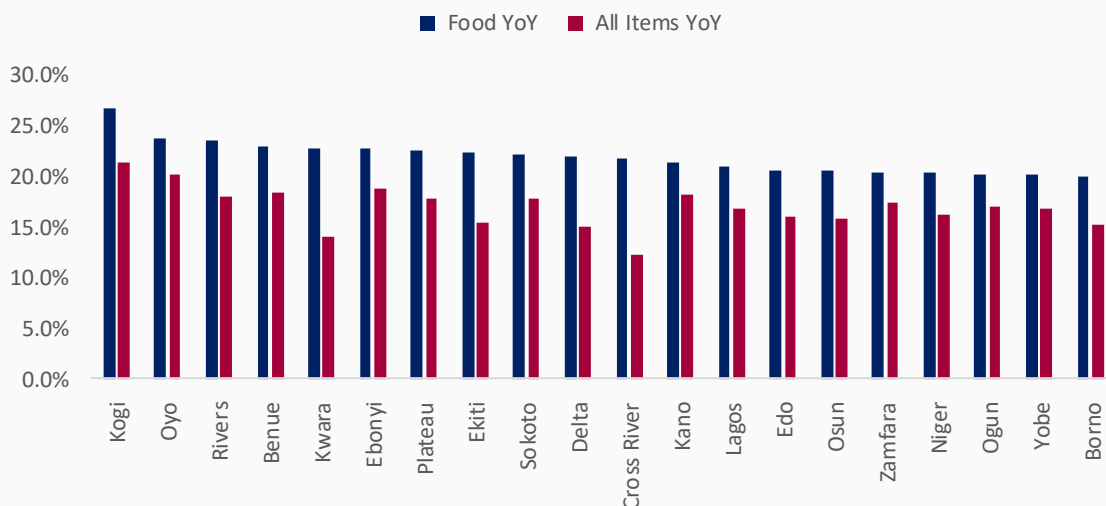


Uncertainty over PMS price—a clear indication inflation concerns could linger

In line with our forecast, Nigeria's headline inflation accelerated 71bps to 16.47% YoY in January 2021. Notably, food inflation surged to 20.57% YoY (highest reading in over 12 years), even though the re-opening of land borders may have contributed to temperance in month-on-month reading. Core inflation also accelerated 48bps from December 2020 to 11.85% YoY in January 2021. On a month-on-month basis, headline inflation rose by 1.49% in the review month (compared to 1.61% YoY in December) on relatively tempered food reading of 1.83% (vs 2.05% in the prior month). The moderation in food inflation may have simultaneously offset the 1.26% (1.10% previously) month-on-month core inflation in the review month.

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Figure 1: Food and All Item inflation hot spots in Nigeria

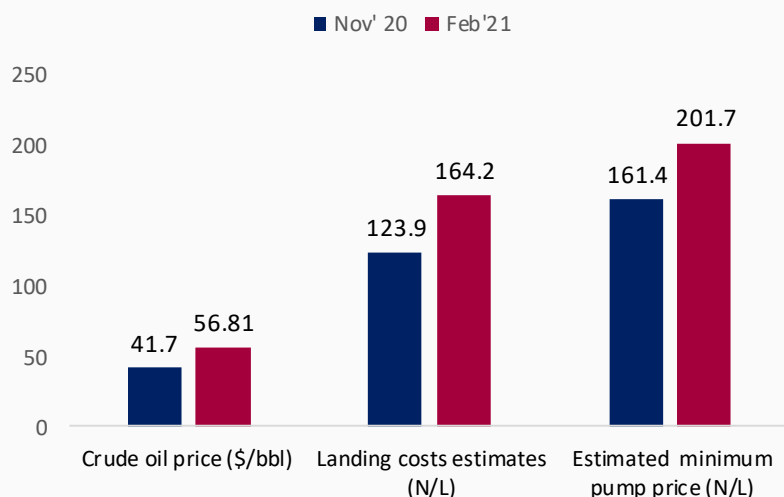


Sources: NBS, CardinalStone Research

PMS price could be a critical inflation driver in 2021

Our 2021 outlook report highlighted the tripod of higher electricity tariff, potential naira devaluation, and PMS price increases as the biggest threats to inflation in the current year. The duo of higher electricity tariff and currency pressures (especially at the parallel markets) are already beginning to take a toll on domestic prices, in our view. However, a material increase in PMS prices could take inflation numbers to more worrying territories. To our minds, the decision to raise fuel prices may be a matter of "when" and not "if" as crude oil prices continue the ascendancy observed since the turn of the year. The rise in crude oil prices from c.\$40 in November 2020 to over \$60/bbl in February 2021 has had a knock-on effect on landing costs. Specifically, landing costs have risen from N123.89/litre in October 2020 to c.N151.70 in February 2021. The change in other direct cost elements also suggests that domestic pump prices should be c.N205/litre, a far cry from the current N162.50/litre that suggests an inadvertent return to subsidies.

Figure 2: Pricing template suggests that PMS could be worth over N200/litre upon adjustments



Sources: PPMC, CardinalStone Research

Given the government's previous stance on deregulation, the rising landing cost may very well be the harbinger of a material increase in PMS prices, which could drive renewed inflationary pressures. Indeed, the Minister of Finance stated that fuel subsidy provisions had been eliminated in the government budgets, suggesting a permanent end to that incentive era. However, we note that previous PMS price increases have provoked notable public backlash despite multiple reminders of the proclaimed downstream sector deregulation. Market watchers will be keeping an eye on **22nd of February** when organised labour and the FG will reconvene to consider the bipartite technical committees' reports on fuel pricing framework and electricity tariff adjustments. For us, we believe a potential 25.0% increase in PMS price is likely to further extend the upward spiral in inflation considering the commodity's ripple effect on prices of products within the core inflation basket. We forecast February headline inflation at 17.18% and project a 2021 high of 18.45% by July. Afterwards, inflation is likely to steadily decelerate in the ember months on the main harvest and border re-opening impact.

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