

Nigeria inflation could hit 20% under new liberalized FX regulatory regime

Since August 2014 as Brent oil spot prices have fallen by 60%, Nigeria’s CPI inflation rates have also surged forward by a corresponding 61%. Thus the May 24 announcement by Nigeria’s central bank of an impending change to the country’s FX management system, which is still yet to be fully fleshed out, threatens to unleash new inflation pressures which could push Nigeria’s CPI towards 20% in coming months. Nigeria’s long-term CPI trends will now begin to mimic inflation trends in Angola and Ghana, where historically CPI levels have been high.

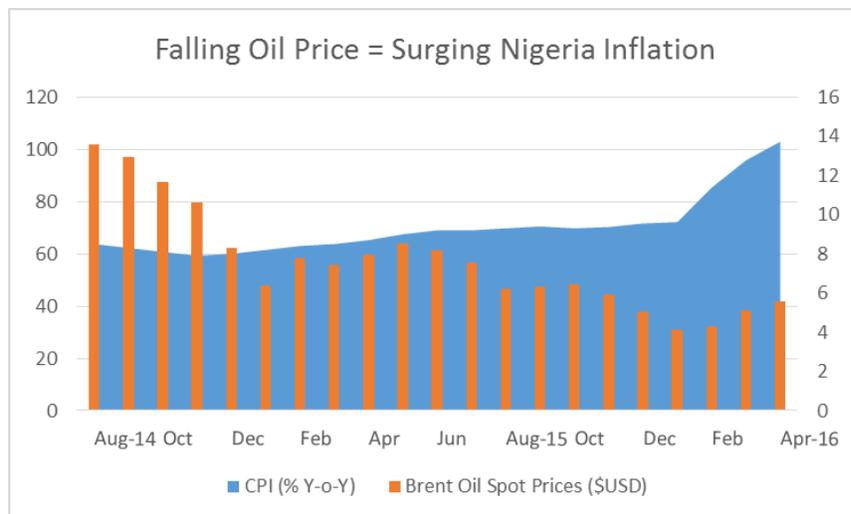
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‘There are two main drivers of asset class returns - inflation and growth’ - Ray Dalio

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Source: EIA/CBN/DaMina Advisors

Between 2003 and now the statistical correlation between changes in Brent oil prices and Nigeria’s CPI was -0.30. Since the 2008 financial crisis, that correlation fell to -0.22, however since the end of the bull market in oil prices in August 2014, that correlation has risen dramatically to -0.57, implying that nearly 60% of the change in CPI in Nigeria is now fundamentally dictated by changes in global oil price levels.

The yet to be fully fleshed out liberalized FX regime will see domestic prices adjust upwards towards Angola-Ghana 20% (+/-) levels while concomitantly boosting the moribund Nigerian stock market as equity prices adjust to compensate for the future anticipated higher inflation levels. Unless handled cautiously and prudently with the explicit support of the president, the Nigerian central banks new liberalized FX regime could easily careen out of control, generate more market confusion and chaotically force the central bank, under heavy political pressure, back into a retreat. The central bank's promise to deepen its quasi fiscal activities will also stymie the effectiveness of the new FX regulatory regime and invite more public and political scrutiny of its oncoming actions.

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