NEW THINKING. NEW OPPORTUNITIES.

Economic Research **17 December 2019**

Economic Commentary

Headline Inflation Ticked up 24bps to 11.9% Year-Over-Year in November

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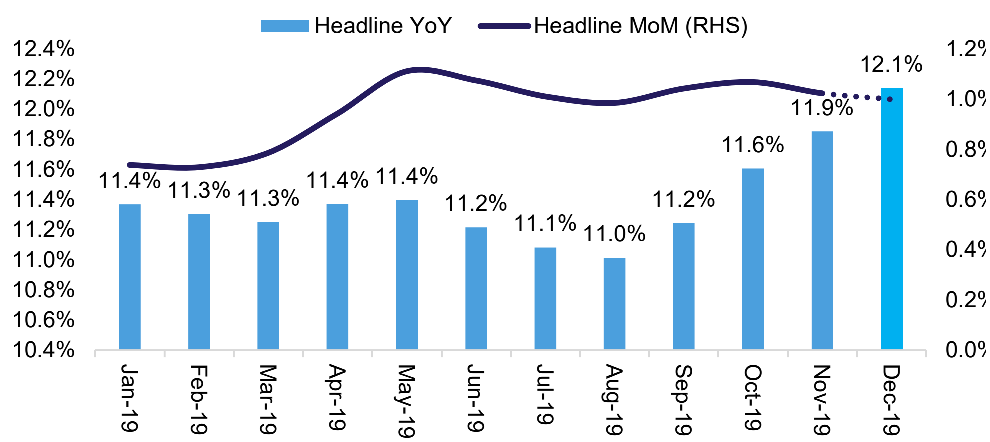
- Core price index grew by 11bps to 8.99% YoY
- Nigeria Treasury Bills negative return sinks further to 4.97%.

Inflation data released by Nigerian Bureau of Statistics this morning showed that headline inflation expanded to 11.85% year-over-year (YoY) from 11.61% in October. Much of the expansion over the past three months stemmed from the feedthrough of the land border closure on food prices, which more than outweighed the onset of the main harvest season. However, in a slight twist from the prior month wherein the core index decelerated, it expanded 11bps to 8.99%YoY compared to 8.88% in October. Food price growth on the other hand maintained the uptick, expanding 41bps to 14.48% YoY from 14.07% in October. As a result, the twelve-month average headline rate settled at 11.35% (5bps higher than 11.30% recorded in October). With our expectation of further uptick in the headline number to 12.14% in December, we expect the average for the year to settle at 11.41% YoY (2018: 12.15% YoY).

Figure 1: Inflation Trend over 2019: YoY and MoM

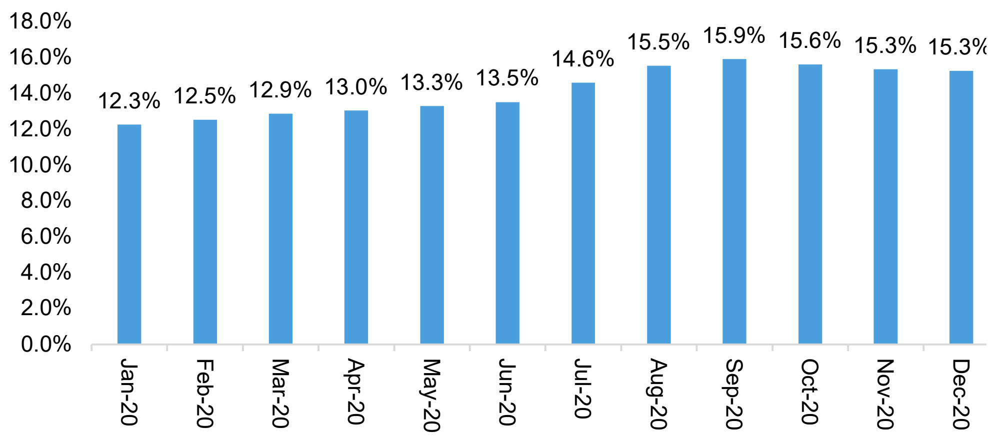


A much closer look at the month-on-month numbers showed some reprieve in the rate of expansion, with headline inflation decelerating by 4bps to 1.02% month-over-month (MoM). The moderation largely mirrored slowdown in food inflation by 6bps to 1.26% MoM, with the impact on the overall headline muted by the 5bps increase in core index to 0.79% MoM. On the core leg, we believe the MoM expansion largely reflects moderate expansion in average price of premium motor spirit by 32bps MoM to N145.94 (October: N145.48).

Overlaying the twelve-month average rate on average fixed income yield of 8.37% and the closing rate of the 364-Day NTB at last week's auction of 6.88%, translates to negative real return of 348bps and 497bps respectively. We believe the level of real return and the somewhat illiquidity at the OMO space will continue to constrain the rate of FPI inflows into the country and a further depletion in the FX reserve.

Going into 2020, we believe the catalyst of inflation will not be so far from what we witnessed in 2016 when the MYTO review took effect in February and an upward adjustment to the pump price of PMS in May. While we do not see an abrupt change in the pump price in 2020 (even with the PPPRA template suggesting open market price of N172.73), our channel checks reveal that the proposed increase in MYTO tariff would kick off in the second half of 2020. The MYTO tariff alongside our expectation of slight depreciation in the Naira early next year (and more noticeable depreciation in the second half) suggests much more pressure on inflation over the year. While the direction of the border closure is yet to be determined, we believe it will be resolved earlier in the year and assume muted impact Q1 inflation numbers. Accordingly, we estimate expansion in average inflation rate in 2020 to settle at 14.1% on our base case.

Figure 2: Forecast 2020 inflation trend



Our broad expectation of an uptick in inflation over 2020, could inform a change in the direction of monetary policy. While economic growth has been the anchor for monetary policy over 2019, (which was supported by the softened inflationary trend and FX stability), we believe further depletion in the FX reserve (down $3.5 billion year-to-date) and expected uptick in inflation guides to upward adjustment in the monetary policy rate in 2020. However, before a change in the MPR rate, we do not rule out some form of administrative measures to limit the rate of FX depletion. The most sacrosanct for us is an upward adjustment in NTB primary market auction rates gradually to the level at OMO to attract FPI flows. In all and from a portfolio allocation standpoint, we believe a tactical short position in treasury assets will accumulate mark-to-market gains going into 2020.