17 March 2020 **Economic Research**

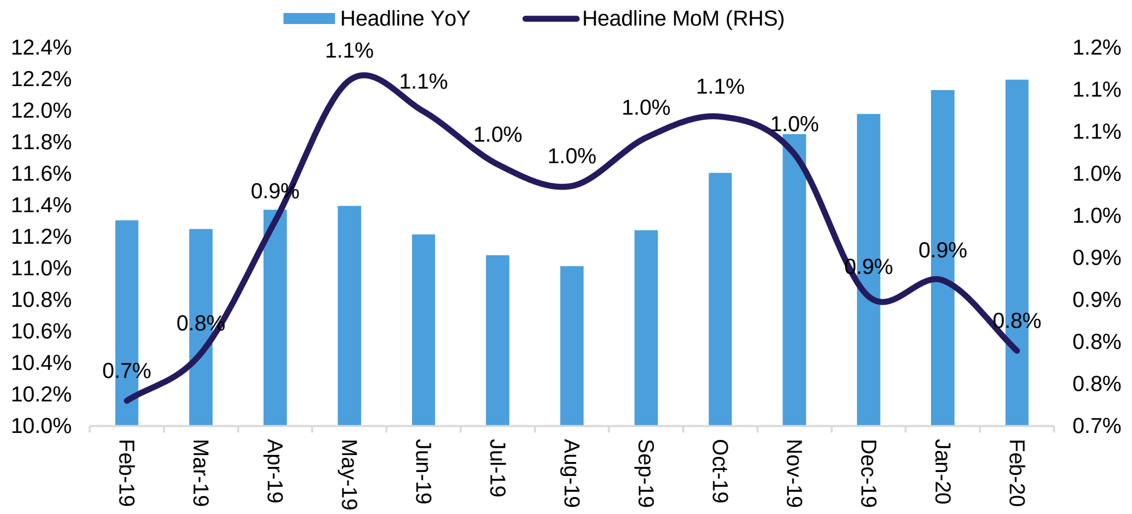
Economic Commentary

Breakup in Supply Chain Portends Major Risk for Price Stability

- Headline inflation ticked up by 7bps to 12.13% year-over-year (YoY) in February
- Core price index grew at a faster pace by just 9bps to 9.43% YoY
- Food price index grew by 6bps to 14.90% YoY

Inflation data released by the National Bureau of Statistics this morning showed consumer prices rose by 0.79% MoM in February, coming below 0.82% MoM in January and our forecast of 0.85% MoM change. The moderation compared to the prior month was largely mirrored in both the food and the core index. The food index declined 12bps MoM to 0.87% (to mark the slowest MoM change in more than twelve months) following a sharp decline in processed food by 60bps to 0.99% which was further supported by 7bps softness in farm produce to 0.86% (a fallout of buoyant market supplies of tubers, millet, rice, and maize remain despite the conclusion of the main harvest season). For the Core index (-9bps MoM to 0.73%), the decline stemmed from most constituents, including Clothing & Footwear (-12bps to 0.76% MoM), Health (+19bps to 0.80% MoM), Transport (-5bps to 0.75% MoM) and HWEGF (-3bps to 0.54% MoM).

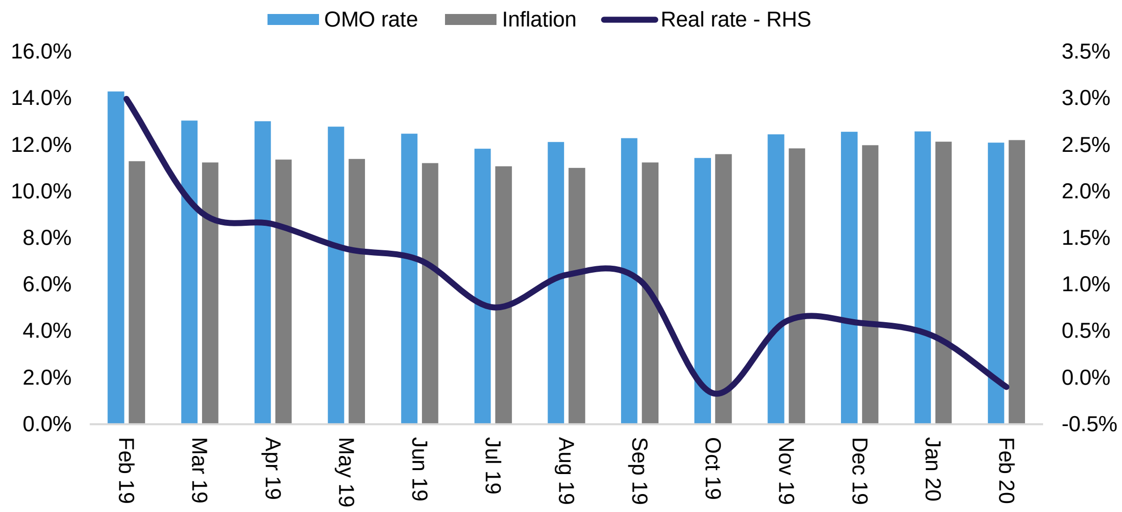
Figure 1: Inflation Trend: YoY and MoM



Source: NBS, NOVA Research

On a YoY basis, headline inflation expanded by 12.20%, coming ahead of January level of 12.13% and below our estimate of 12.27%. The expansion emanated from increases in both the core and food index. Surprisingly, while the core index (9bps to 9.43% YoY) had been muted in the prior month, it increased at a much faster pace compared to the food index in the month of February, following increases in HWEGF (+21bps to 7.81%), Transport (+12bps to 9.43% YoY), Health (+8bps to 9.94% YoY) amongst others. The food index (+6bps to 14.90% YoY) continues to reflect the low base of the prior year, which is further espoused by the feedthrough of the land border closure on food prices (with a gradually fading impact as seen in the MoM movement). Relative to same period in the prior year, the food index is 143bps higher than the February 2019 level of 13.47% YoY while the growth in the core index moderated by 37bps from 9.80% YoY in February 2019. Overlaying the twelve-month average rate on average fixed income yield of 7.75% and the closing rate of the 364-Day NTB at last week's auction of 5.30%, translates to negative real return of 445bps and 690bps respectively.

Figure 2: Trend in Real Rate of Return



Source: NBS, FMDQ, NOVA Research

As discussed in our Economic Update (See Report: [Global Shocks Alters Nigeria's Short Term Outlook]) published yesterday, we cited that the ongoing supply shocks and attendant disruption from breakup in the supply chain on manufacturing and trade activities portends major risk for price stability. We stated that the feedthrough from scarce imported commodities and higher demand for local substitutes could also transmit to temporary higher prices. While we do not doubt CBN's ability to continue to defend the Naira and provide import supplies, the invalid segment of the market will witness significant pressure as demand builds up at the parallel market. Even for the valid imports, we believe the active management of FX allocation could create scarcity and delays in allocation which will inevitably push importers to seek FX at the unofficial segment. Further overlaying the supply shocks on expected impact of the persisting border closure, expected higher electricity tariff and dollar scarcity, we believe an upward adjustment might be necessary as supply disruptions intensifies. As such, we see further increase in YoY inflation rate in the coming months.

HWEGF - *Housing, Water, Gas, Electricity, and other Fuel*