

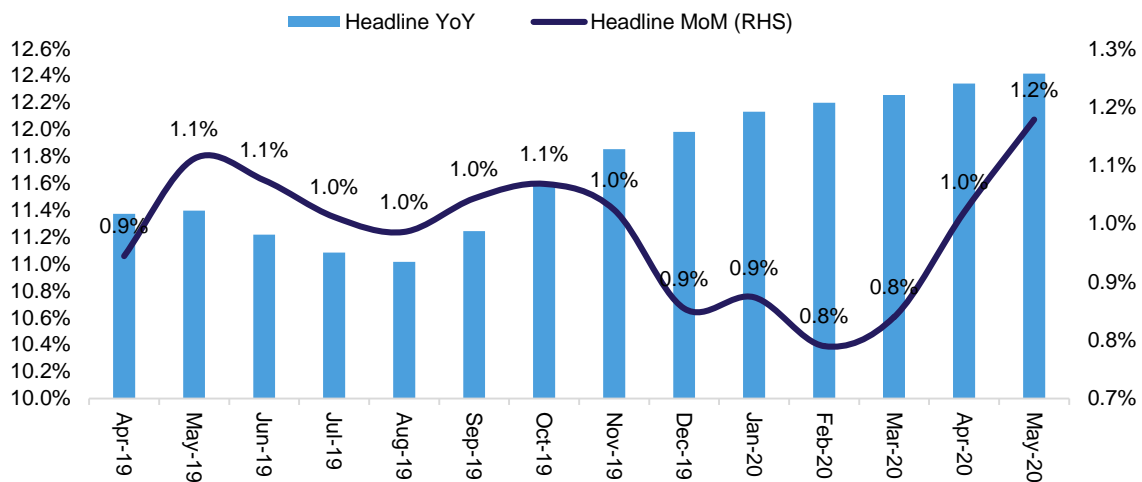
Economic Commentary

Headline CPI at Highest Since May 2018

- Headline CPI ticked up by 7bps to 12.40% YoY, highest since May 2018
- Core inflation grew by 14bps to 10.12% YoY, highest since August 2018
- Food price index flat at 15.03% YoY

The impact of foreign exchange scarcity and supply chains disruptions became more evident on the core index in the month of May, with core prices reaching the highest level last seen in August 2018. The core index grew by 14bps to 10.12% YoY reflecting the impact of interstate travel restriction on prices of essential items and feedthrough of the Naira depreciation on prices of imported foods and other imported components. Specifically, key components of the core basket expanded, starting with imported food (+2bps to 16.26% YoY), Transport (+32bps to 10.66% YoY), Communication (+13bps to 8.47%), Health (+40bps to 10.66% YoY), clothing (+8bps to 10.40% YoY), amongst others. Elsewhere, while the bountiful harvest during the off season (April and June 2020) kept market well supplied with farm produce largely flat at 15.03% YoY, the supply chain disruptions necessitated increase in prices of processed foods by 11bps to 14.8% YoY.

Figure 1: Inflation Trend: YoY and MoM

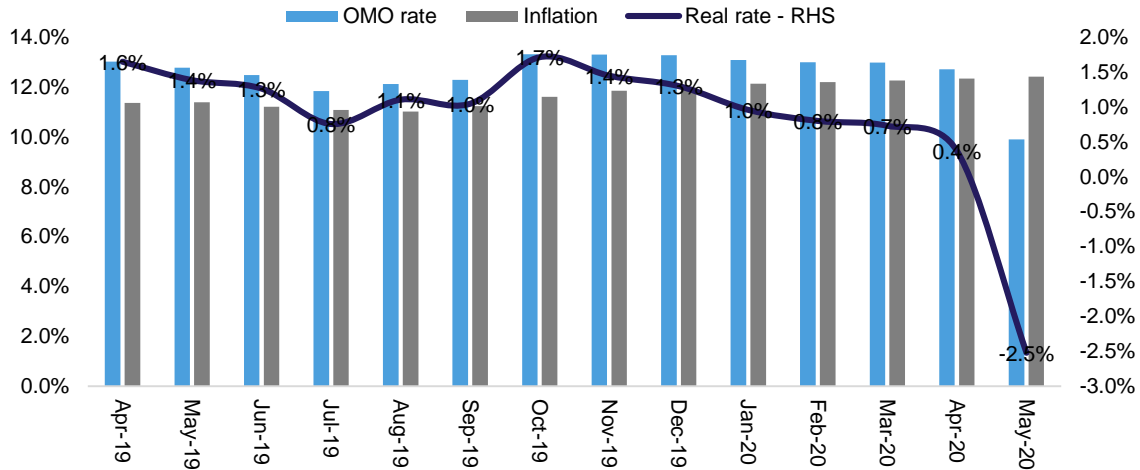


Source: NBS, NOVA Research

Similar to April, the month-on-month inflation reached a new high of 1.18% MoM in May (highest MoM since July 2018), coming above 1.02% MoM in April. In a completely different twist from the YoY inflation, much of the expansion in MoM inflation in May emanated from faster increase in food prices (+24bps to 1.42% MoM), defying the impact of the bountiful dry season harvest due to feedthrough of higher transportation cost and associated increased demand during Ramadan. Particularly, farm produce rose 40bps to 1.53% MoM (which is not unrelated to Ramadan demands), to outweigh the decline in processed foods (-151bps to 0.23%) over the same period. Further supporting our view of complete divergence between MoM and YoY triggers, the core index declined 5bps to 0.88% MoM in May.

Relative to same period in the prior year, the food index is 124bps higher than the May 2019 level of 13.79% YoY while the core index increased by 109bps from 9.03% YoY in May 2019. Overlaying the twelve-month average inflation rate on average fixed income yield of 6.52% and the closing rate of the 364-Day NTB at last week's auction of 4.02% translates to a negative real return of 526bps and 776bps respectively.

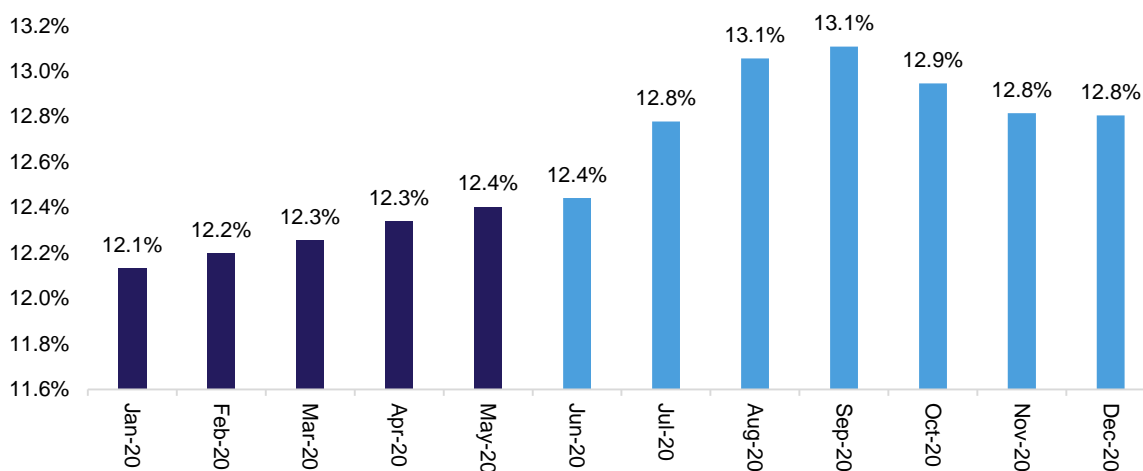
Figure 2: Trend in Real Rate of Return



Source: NBS, FMDQ, NOVA Research

We see the trend in inflation in the month of June, mirroring similar patterns in April and May, albeit at a moderate level given the limited demand for farm produce. We expect the restriction of interstate travels and Naira depreciation to continue to drive prices of essential items upwards. All told, we expect the consumer price index to decline 7bps to 1.11% MoM, with headline inflation YoY expanding to 12.44% YoY in June. We still allow our model to reflect the likely implementation of the higher electricity tariff in July, coupled with our expectation of persistent Naira volatility, elevated transportation cost due to social distancing policy and higher cost of essential items. All told, we expect average inflation rate for 2020 to settle at 12.6% on our base case.

Figure 3: Forecast 2020 inflation trend



Source: NBS, NOVA Research Estimates