15 September 2020 **Economic Research**

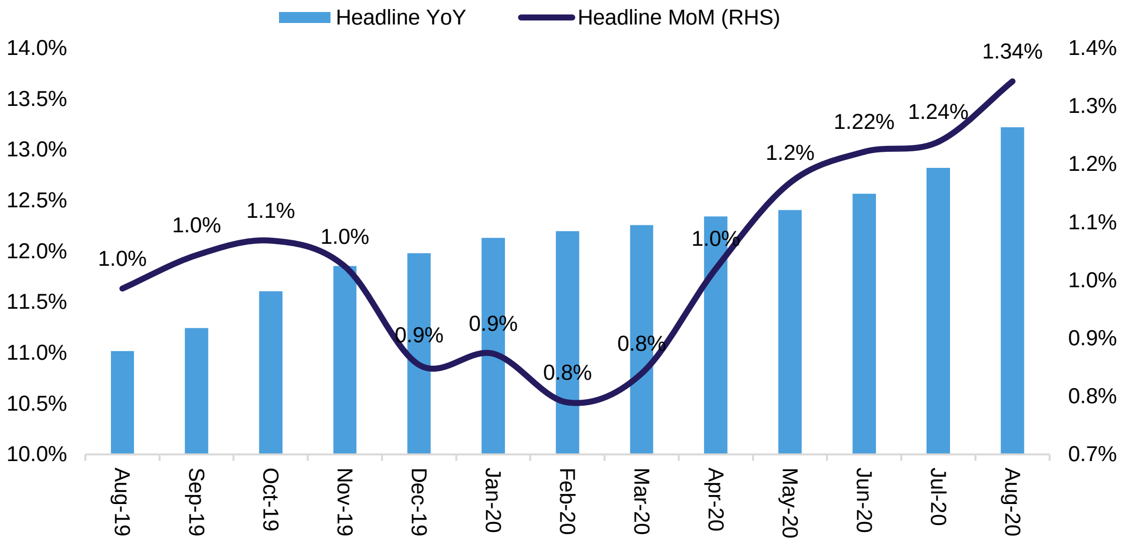
Economic Commentary

Renewed Jump in Core Inflation Compound Pressure on the Headline Index

- Headline CPI ticked up by 40bps to 13.22% YoY, highest since April 2018
- Core inflation expanded by 42bps to 10.52% YoY, highest since June 2018
- Food index jumped 51bps to 16.00% YoY, dominated by increases in prices of farm produce and staple food prices.

The headline inflation index surprised in the month of August, expanding 1.34% MoM, above 1.24% MoM in July and our estimate of 1.12% MoM following still elevated food prices and renewed uptrend in the 'All Items less Farm Produce' (core index). While food prices (expanded on average of 12bps monthly) have dominated the increase in the headline index over the past three months, the core index (declined on average by 6bps monthly) had moderated the impact over the same period. With subsisting pressure on farm produce pushing the food index 14bps to 1.67% MoM in August, the core index increased 30bps to 1.05% MoM. The expansion in the core index reflected increases in the Furnishings (+8bps to 0.925 MoM), Clothing & Footwear (+5bps to 0.95% MoM) and Transport (+3bps to 1.14% MoM) sub-index.

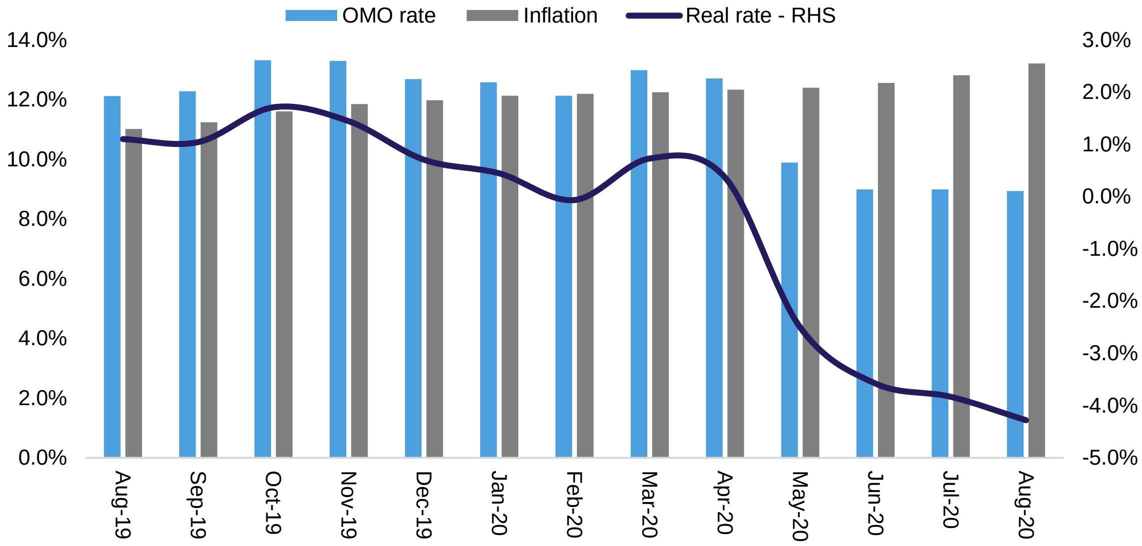
Figure 1: Inflation Trend: YoY and MoM



Source: NBS, NOVA Research

Reflecting the MoM jump, the headline inflation expanded by 13.22%, coming ahead of July level of 12.82% YoY and our estimate of 12.96%. Both the food and core index expanded 51bps and 42bps to 165 YoY and 10.52% YoY. Most constituents of the core index contributed to the rise in the month of August – HWEGF (+16bps to 8.13% YoY), Transport (+41bps to 11.21% YoY), Health (+48bps to 12.09% YoY), Communication (+19bps to 9.01% YoY), clothing (+20bps to 10.80% YoY), amongst others. Relative to the same period in the prior year, the food index is 283bps higher than the August 2019 level of 13.17% YoY while the core index increased by 184bps from 8.68% YoY in August 2019. Overlaying the twelve-month average inflation rate on on average fixed income yield of 4.32% and the closing rate of the 364-Day NTB at last week's auction of 3.05% translates to a negative real return of 790bps and 917bps respectively.

Figure 2: Trend in Real Rate of Return



Source: NBS, FMDQ, CBN, NOVA Research

As mentioned in our Monthly Economic Insights (See report: Consumer Prices to Succumb to Rising Energy Prices), recent upward adjustment in electricity prices and rising PMS/diesel prices due to increasing global crude oil prices will add more pressure to inflationary trend over the next couple of months. On electricity tariff, recall the implementation of the ~58% increase in February 2016 reverberated across industrial and consumer prices. The major impacted area was the core index which incorporates Housing, Water, Electricity, Gas and Other Fuel (HWEGF). By our estimate, the increase in electricity tariff effective September will result in ~89% increase, compared to ~58% increase in 2016. We see every room for the impact to more than supersede that of 2016 and expect to see the full impact on HWEGF in the next couple of months. On PMS/Diesel price, compared to average PMS price of N148.2/litre in August, PMS price increased to N151.6/litre in September with further adjustment over the rest of the year as global oil prices adjust. Interestingly, the upward adjustment to PMS is still below our estimate of N160.8/litre and N165.9/litre using exchange rate of N361/$ and N379/$ respectively and average oil price of $44.5/barrel. The combined impact of increase in electricity tariff, rising diesel/PMS prices and lower than average harvest season will define new levels for inflation in the coming months.

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