FSDH MERCHANT BANK LTD

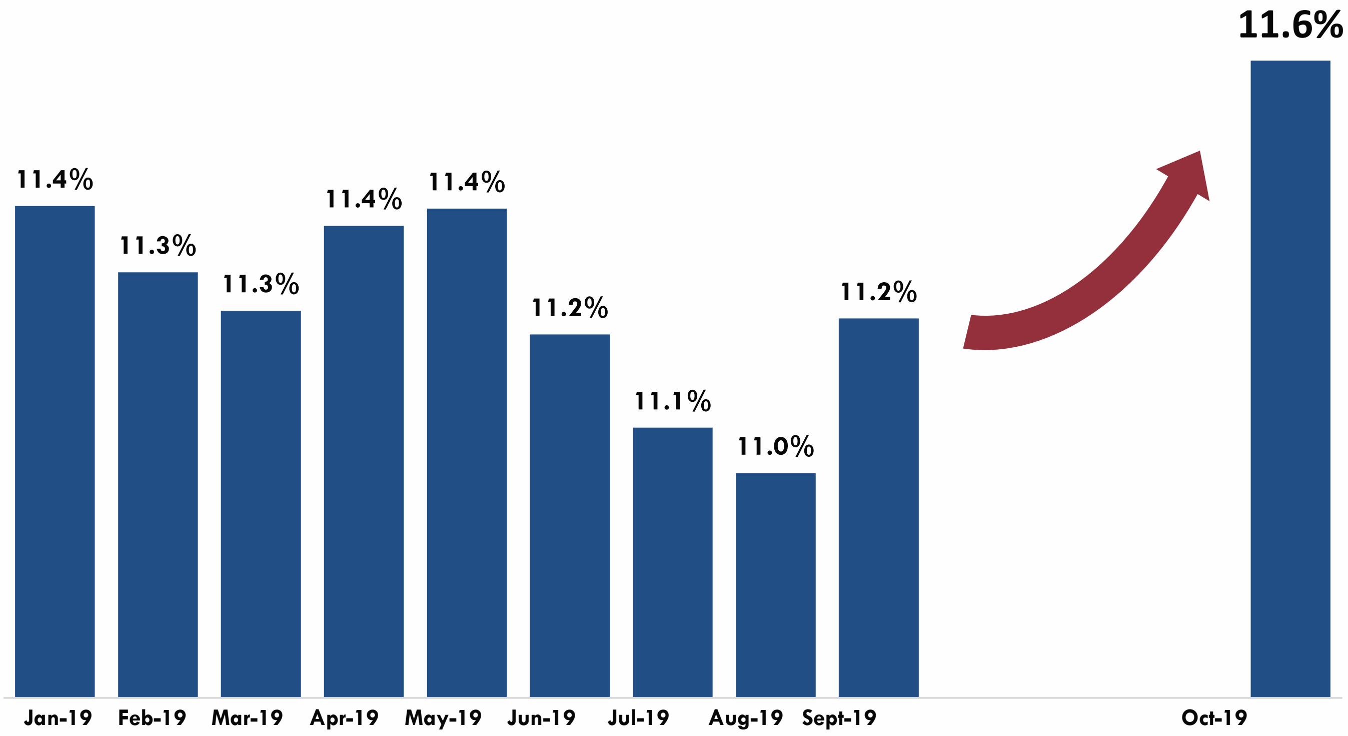
INFLATION NOTE OCTOBER 2019

November 2019

FSDH RESEARCH

Closure of land borders pushes Nigeria's Inflation Rate to 11.6%

Nigeria's Average Inflation Rate

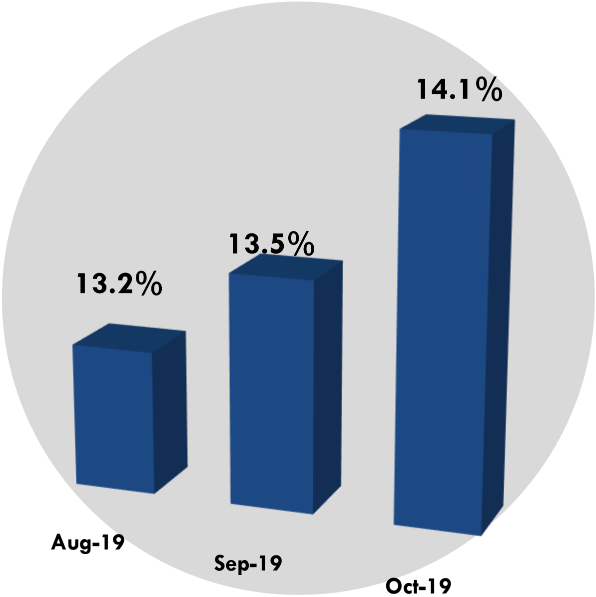


Data Source: National Bureau of Statistics

Closure of land borders pushes Nigeria's Inflation Rate to 11.6%

- Year-on-year Inflation rate increased to 11.6% in October 2019 from 11.24% in September. This is the highest figure since May 2018.
- Overall, inflation in October was triggered by increase in food prices.
- An Increase of 58 basis points was recorded for food inflation which stood at 14.1% in October while non-food inflation rate declined marginally to 8.88% from 8.94% in September.
- According to the NBS, food inflation was caused by increases in prices of "Bread and cereals, Oils and fats, Meat, Potatoes, Yam and other tubers, Fish and Vegetables".
- Although inflation moderated from January to August 2019, inflationary pressures kicked in from September, largely as a result of the closure of land borders.
- The outlook for inflation remains bleak, given the continued land border closure, approaching festive season and proposed tax increase in addition to new taxes/charges.

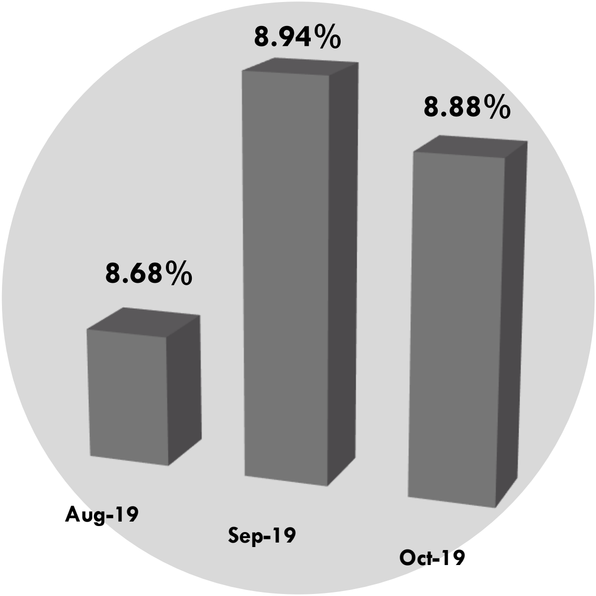
Food Prices trigger overall Inflation Rate



Food Inflation

Food inflation rate rose from 13.5% in September to 14.1% in October 2019, triggered by increases in the prices of rice, fish, oil & fats, etc.

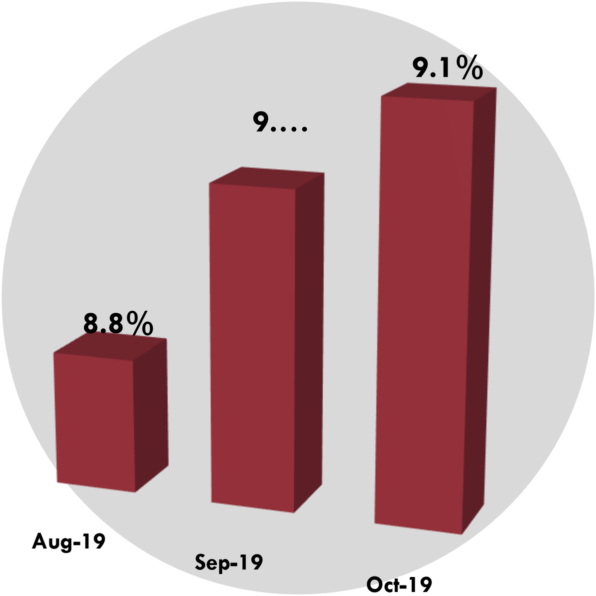
14.1%



Non-Food Inflation

Core inflation rate declined marginal to 8.88% in October from 8.94% in September 2019.

8.9%



Transport Inflation

Transport inflation rate rose marginally from 9% in September to 9.1% in October 2019.

9.1%

What are the impacts of the closure of land borders?

Positive Impacts

Rice production increases
Closure of land borders curbed smuggling and was an incentive for local rice producers to increase output.

Reduction of Smuggling
A significant number of trade across the land borders are informal and some of the goods traded are illegal.

Government Revenue
According to the Customs Service, land border closure led to an increase in government revenue as importers traded via the seaports.

Better Trade
Nigerian government has held meetings with officials of Niger and Benin Republic and proposed conditions that these countries must adhere to.

Closure of land borders

Decline in Exports
Some producers in Kano, Aba and other parts of the country that export to neighbouring countries were affected.

Increase in price of rice & other products
Rice producers took advantage of the market gap to increase prices and make abnormal profits.

Increase in food Inflation
The rise in overall inflation rate is connected with increase in the price of rice, given that it is a staple food in Nigeria.

Constrained Choices
Consumers in Nigeria are forced to purchase local rice at higher prices and relatively lower quality.

Negative Impacts

- In November 2019, the Nigerian government engaged with officials of Niger and Benin Republic on the land border closure.
- The government prescribed some conditions that must be met by the two countries before the land borders would be opened. Some of the conditions include:
  - Compliance with rule of origin
  - Compliance with agreed packaging standards and rules
  - Dismantling of warehouses around the borders.
- The closure, according to the Director General of Nigeria Customs Service, is expected to last till January 31st 2020, pending compliance with the above conditions.
- This policy stance could be viewed as a setback in promoting free trade in Africa, especially given Nigeria's recent commitment to the AfCFTA agreement.

Inflation Outlook is bleak!

Taxes & Other charges

To shore up government revenue, the government has proposed several taxes and charges for 2020, which could result in higher prices. Some of these taxes include VAT, Communication Tax, Online Tax, Toll Charge, Taxes on Carbonated soft drinks, etc.

Infrastructure Deficit

Challenges of poor power supply, bad roads and poor road networks persist and they are traditional sources of inflation in Nigeria.

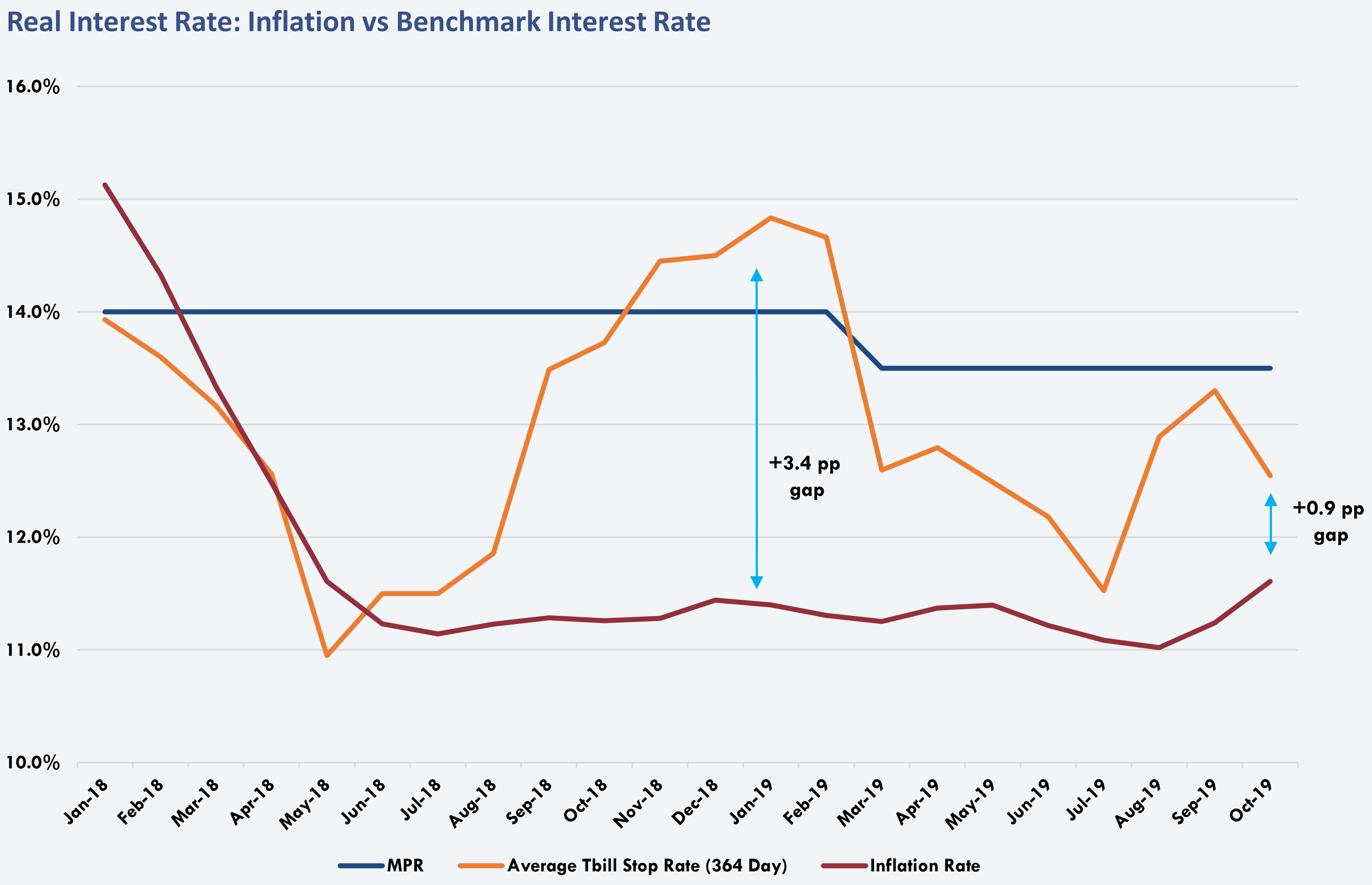
Closure of Land Borders

Continued closure of land borders will result in higher prices of affected commodities such as rice, poultry products, etc.

Government Spending

With a proposed 2020 budget of N10.3 trillion, government spending poses a risk to inflation. Increase in minimum wage to N30,000, if implemented across states, is also expected to result in higher prices.

Real Interest Rate margin narrows further



*pp - percentage points

- **Inflation rate has trended upward for two consecutive months to reach 11.6% in October.**
- **When compared with the MPR, upward movement in Inflation rate narrowed real interest rate margin to +1.9 percentage points (pp) in October from +2.5 in August.**
- **For the 364-day Treasury bill, real interest rate margin which was +3.4 percentage points in January 2019 fell to +0.9 in October, owing to falling interest rates and rising inflation.**
- **The recent increase in inflation rate coupled with inflationary pressures are huge concerns for monetary authorities.**
- **This rules out the likelihood of a reduction in Monetary Policy Rate (MPR) at the November MPC meeting, especially given the improved 2.3% GDP growth figure in 2019Q3.**

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Data Source: National Bureau of Statistics & Central Bank of Nigeria

Macroeconomic Projections (Annual)

	2016	2017	2018	2019f
GDP Growth	-1.6%	0.8%	1.9%	2.3%
Inflation	15.6%	16.5%	12.1%	11.4%
Exchange Rate (N/US$)	490	363	358	358
External Reserves (US$ Billion)	27.0	39.4	43.1	44
Monetary Policy Rate	14.0%	14.0%	13.5%	13.5%
Investment as a % of GDP	14.9%	14.8%	17.0%	23%

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