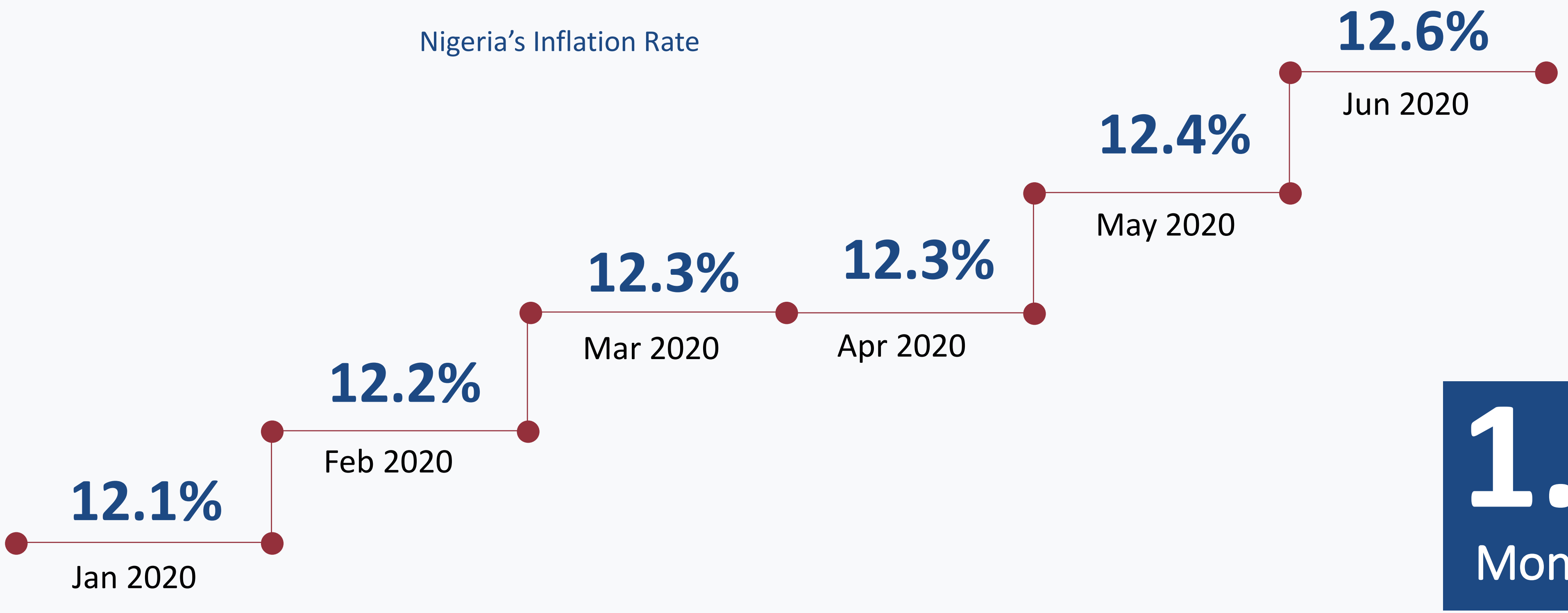
Inflation rate rises to 12.6% in June 2020

Nigeria's Inflation Rate



1.21%
Month-on-Month

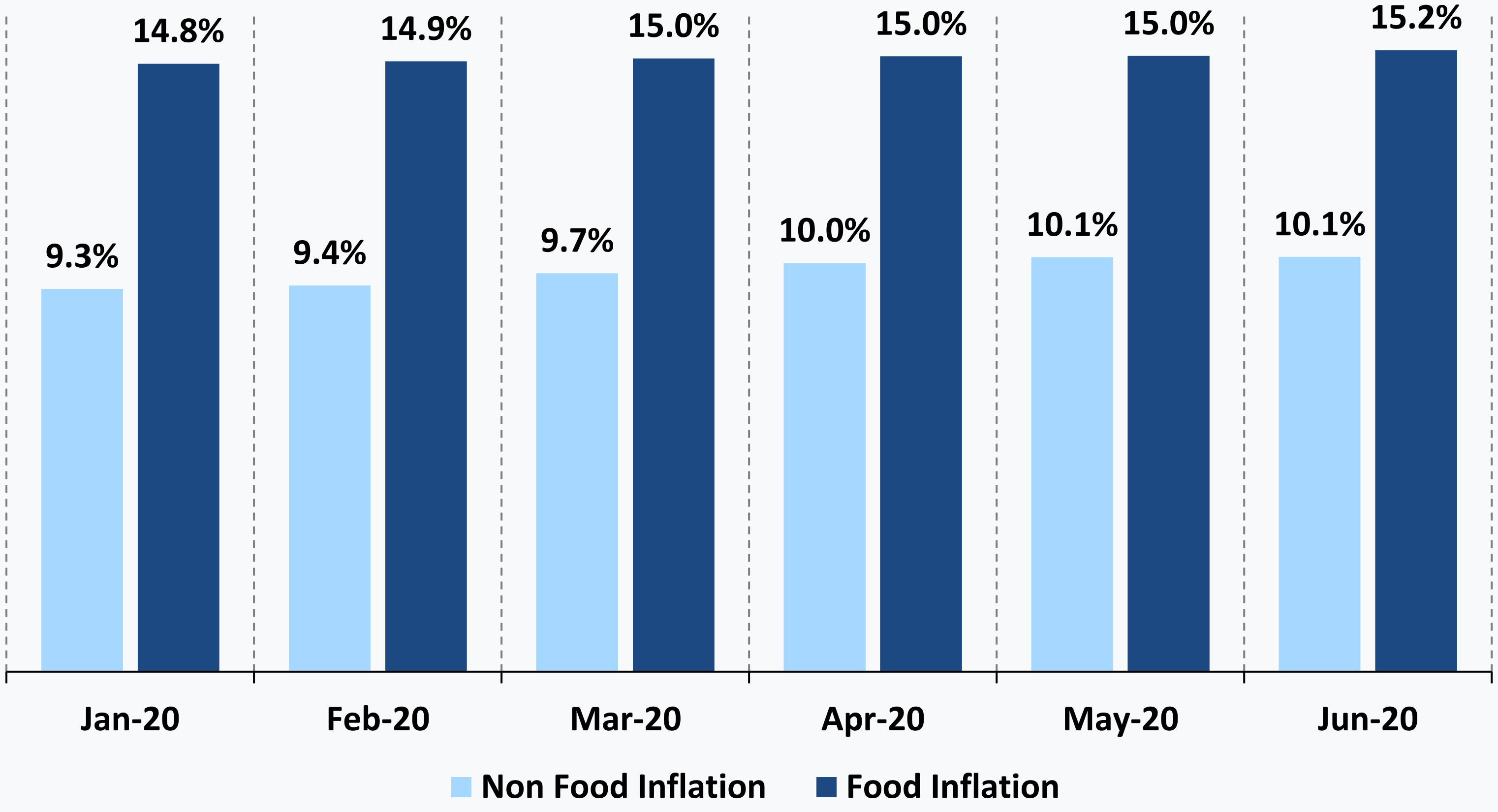
On a month-on-month basis, Nigeria's inflation rate was 1.21% in June, the highest in two years.

- **Headline inflation rate rose to 12.56% in June 2020, a 15 basis points increase from 12.4% in May 2020.**
- **Inflation rate in June is the highest since March 2018.**
- **Increase in food prices remains a major driver of inflation in Nigeria.**
- **Factors such as exchange rate depreciation, supply chain disruption and rising transport costs are responsible for the upward trend in inflation rate.**

Data Source: National Bureau of Statistics

Food inflation continues to drive overall inflation

Nigeria's Food & Non-Food Inflation Rate



- In June 2020, average food prices increased by 15.2% when compared with prices in June 2019.
- Food inflation in the month was driven by increases in the price of Bread and Cereals, Potatoes, Yam and other tubers, Fruits, Oils and Fats, Meat, Fish and Vegetables.
- Non food inflation rate stood at 10.13% in June 2020.
- Increase in this segment has been driven by rising price of transport and health services.
- We expect inflation to trend upwards in coming months given imminent pressures from exchange rate depreciation and supply side constraints.
- By our estimates, inflation rate is expected to average 12.85% in 2020.

RESEARCH

Data Source: National Bureau of Statistics

In June, Health recorded the highest year on year increase in inflation rate

1. **Health Inflation – 11.1% (June 2020)**

Higher demand for health care services as a result of COVID-19 outbreak contributed to the 180 basis points increase in health inflation from 9.3% in June 2019.

2. **Miscellaneous Goods and Services – 10.2%**

Inflation rate in this segment has trended upwards from 8.6% in June 2019 to 10.2% in June 2020. High import costs, higher demand coupled with exchange rate depreciation are key factors.

3. **Food & Non Alc. Beverage – 15.1%**

Higher demand, supply chain disruption and closure land borders continue to drive up prices for food and beverages.

4. **Transport Inflation – 10.4%**

Transport inflation rose to 10.4% in June 2020. This is due to social distancing policies, movement restrictions, higher fuel costs and infrastructure bottlenecks.

5. **Restaurant & Hotels- 9.5%**

Restaurants and Hotels are one of the hardest hit areas in this pandemic era due to lockdowns and restrictions. Inflation has increased from 8.2% in June 2019 to 9.5% in June 2020.

6. **Recreation & Culture – 9.1%**

Inflation in this segment has increased by 100 basis points to 9.1% in June 2020 from 8.1% in June 2019.

Key drivers of Inflation in the last one year include closure of land borders, infrastructure deficit, exchange rate depreciation, rising transport costs, lockdowns & movement restrictions and VAT increase.

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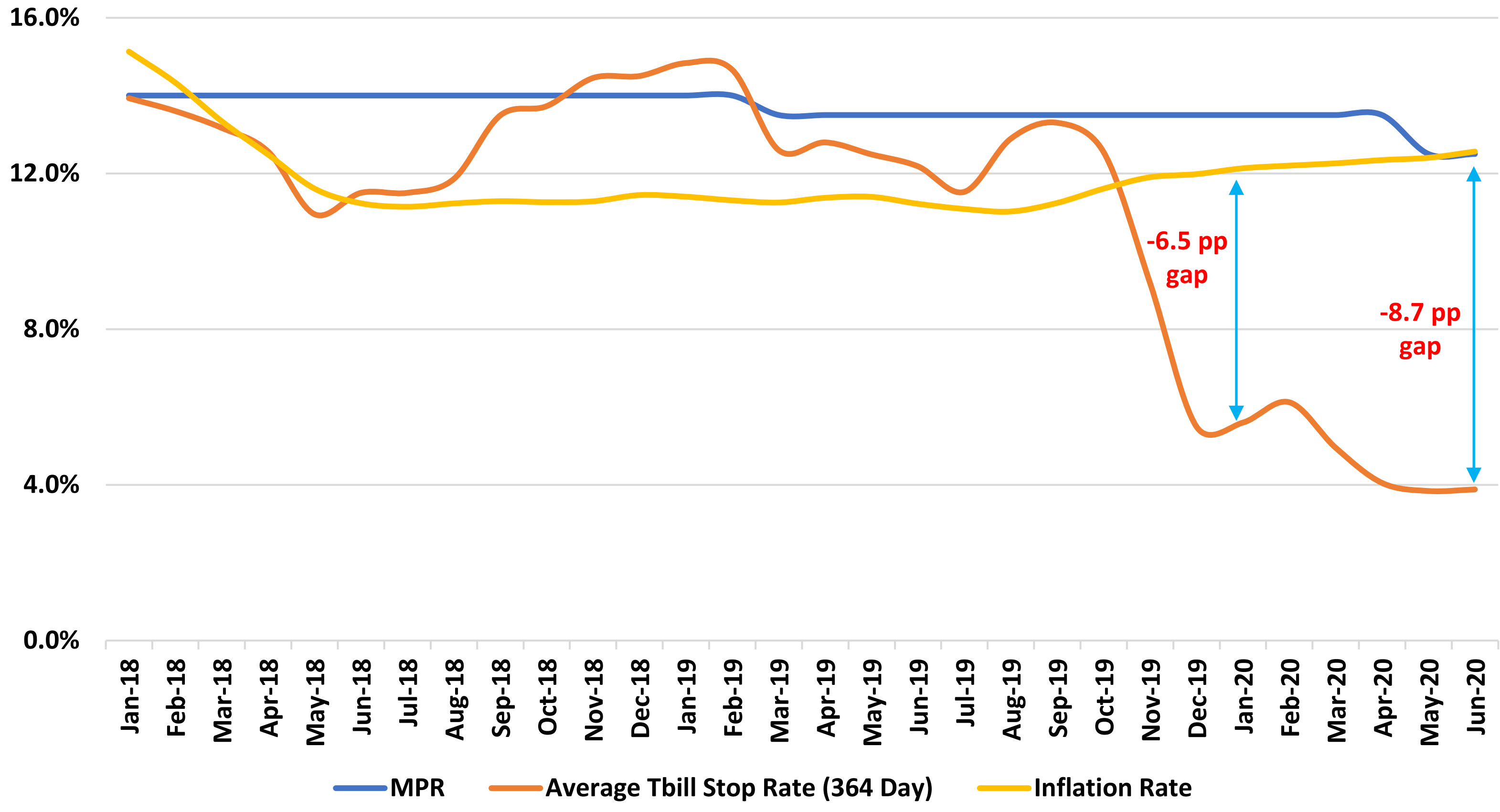
Data Source: National Bureau of Statistics

Real interest rate expands from -6.5 percentage points in Jan 2020 to -8.7 in June

Real Interest Rate: MPR, 364-Day Treasury Bill Average Rate vs Inflation Rate



*pp - percentage points

- Real interest rate continues to expand as inflation trended upwards in June.
- The gap between 1 year Treasury Bill rate and inflation rate expanded to -8.7 percentage point (pp) in June 2020, from -8.6 pp in May 2020.
- For the first time since February 2018, inflation rate exceeded the MPR by 0.1pp in June 2020, resulting in a negative real interest rate.
- With inflation expected to rise further in coming months, we expect a further extension of real interest rate, particularly in relation to the MPR.

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

MPC holds MPR at 12.5% amidst rising inflation and currency pressure

On July 20, the CBN Monetary Policy Committee (MPC) held its fourth meeting of 2020. At the meeting, the Committee took the following decision:

- Retain the Monetary Policy Rate (MPR) at 12.5%;
- Retain the asymmetric corridor of +200/-500 basis points around the MPR;
- Retain the CRR at 27.5%; and
- Retain the Liquidity Ratio at 30%.

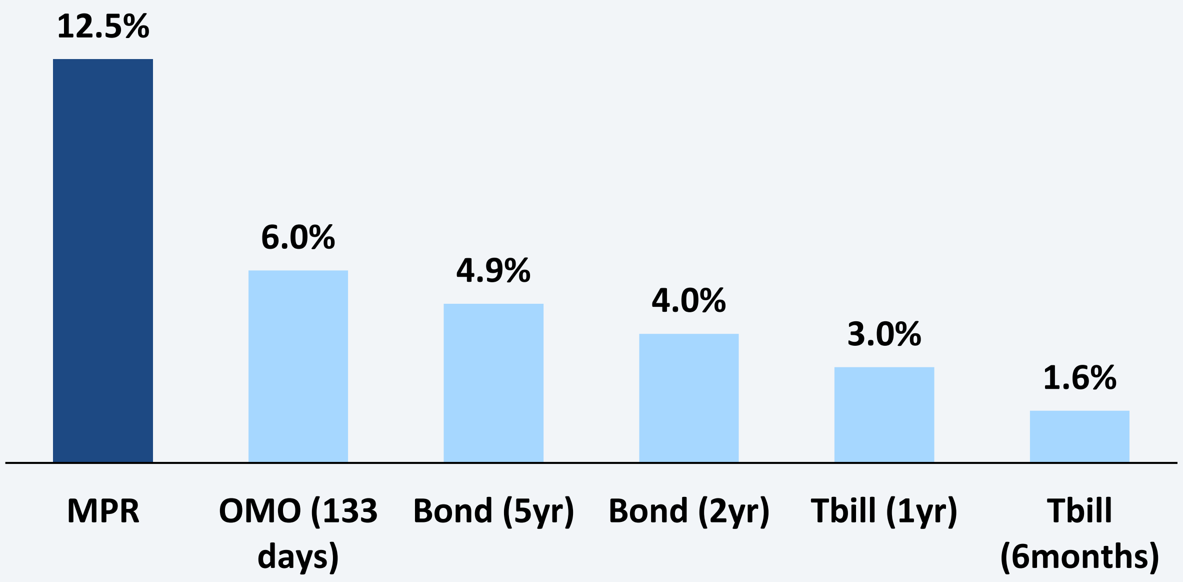
This decision was based on the following considerations:

- Need to observe the effects of the cut in MPR at the previous meeting.
- Need to evaluate the effectiveness of fiscal and monetary response to revive the economy amidst the COVID-19 pandemic.
- Need to strike a balance between output growth and price stability.
- The gradual improvement in economic activities following the lockdown in April.
- Heightened inflationary pressure arising from both monetary and structural factors.

fsdh RESEARCH

Inflation, NPLs, External Reserves, Liquidity to dominate concerns in 2020

Interest rates/yields across instruments



Data Source: CBN, FMDQ

Notes on the MPC decision

- While the decision to hold is expected given rising inflation, we also observe the weakened efficacy of the benchmark rate (MPR), especially given the huge disparity among interest rates- MPR, lending rates, T-bills rate, OMO, Bond yields among others.
- Addressing this disparity remains crucial in ensuring, confidence, stability and attracting investments into different segments of the markets.
- More recently, the Cash Reserve Ratio (CRR) appears to be a more useful tool for liquidity management. However, pursuing a high CRR coupled with the loan-to-deposit (LDR) policy, which compels banks to lend to businesses will tighten banking liquidity and could have implications on non-performing loans and overall growth.
- This, coupled with rising inflation and pressure on external reserves will be major concerns for the MPC in coming months.