

Impact of High Inflation on Saving & Defensive Strategies to Adopt

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OUTLINE OF Presentation



- Introduction
- Nigeria's Inflation: Trend and Impact
- Income – Saving (Investment) Relationship
- Inflation Rate and Assets Returns – US Case Study
- Inflation Rate and Assets Returns in Nigeria
- Defensive Strategies during Inflationary Periods
- Summary and Implications



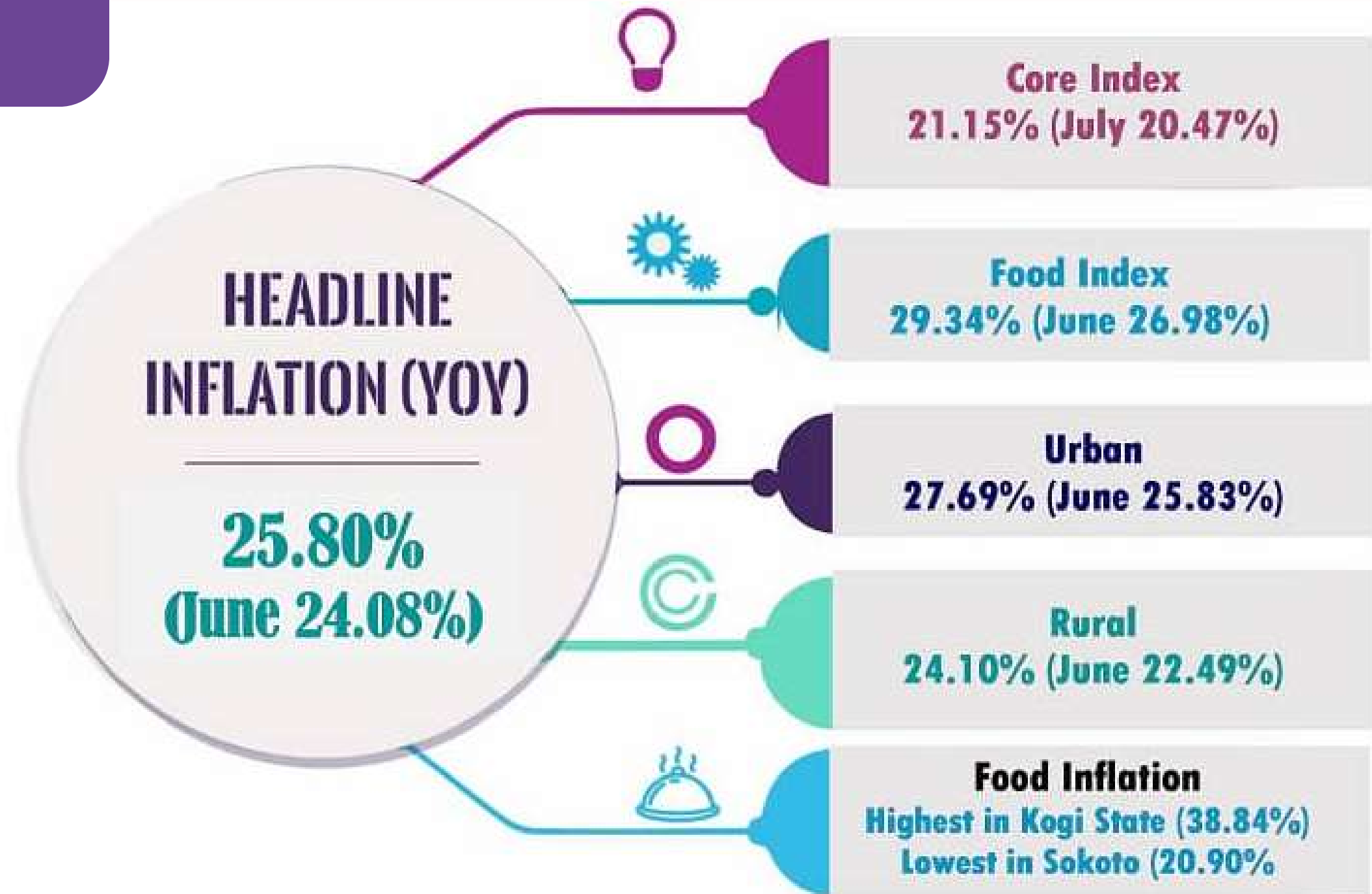
Introduction

- Inflation is a major economic phenomenon which affects a country's macro- and micro-economic environments.
- Achieving a low and stable inflation rate is a major macroeconomic objective.
- When inflation is high and volatile, it creates a lot of distortions in the economy.
- For instance, it affects citizens purchasing power, level of welfare and expectations of returns on their savings and investments.
- It is therefore critical to evaluate how citizens can effectively save and invest in a period of high inflation.

NIGERIA'S INFLATION

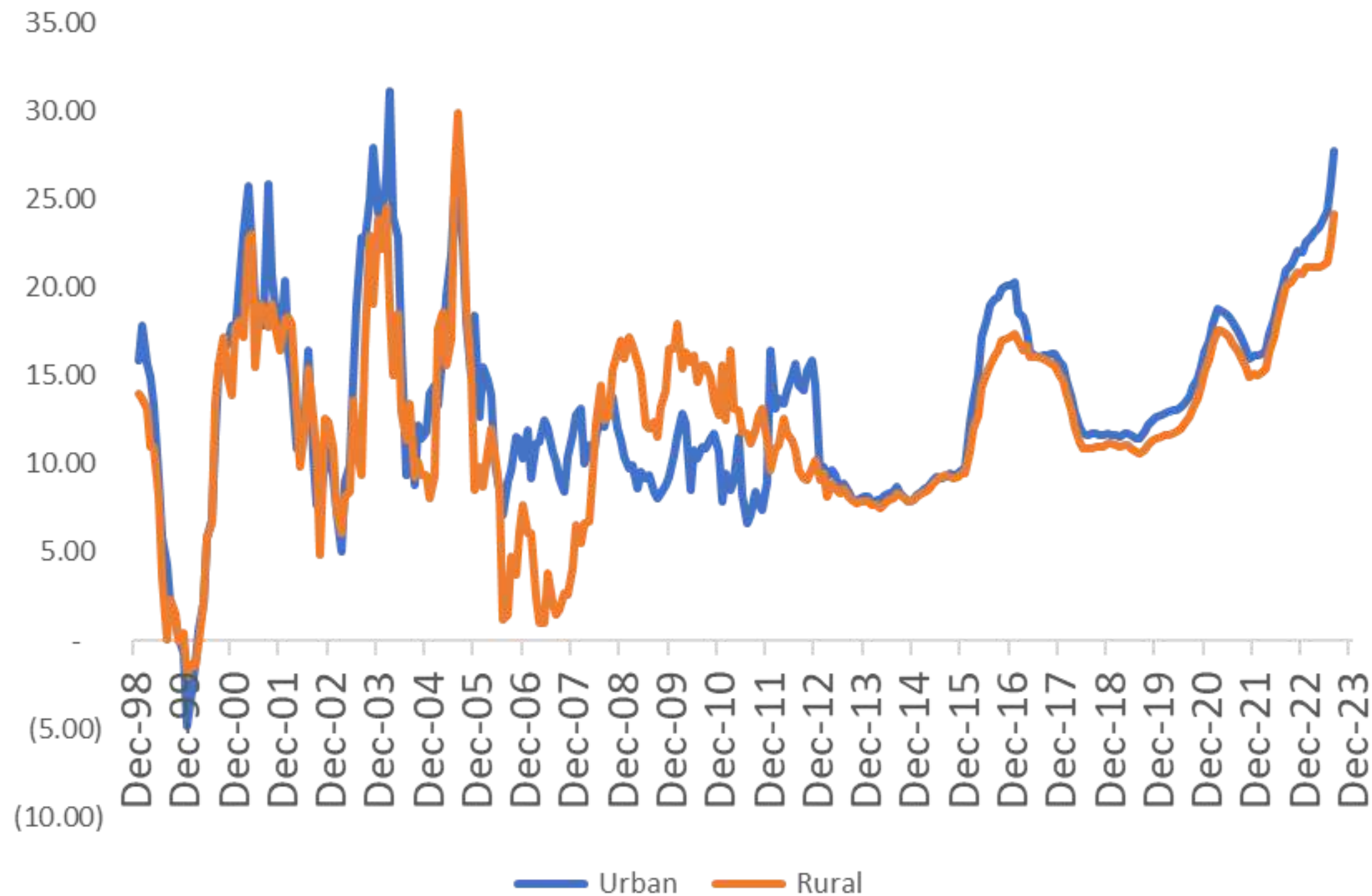
Status

- Inflation came in at 25.8% in August, 2023
- An 18-year high
- 27.69% for Urban
- 29.34% for food



SOURCE: NBS, ADSR RESEARCH

TREND OF Nigeria's Inflation



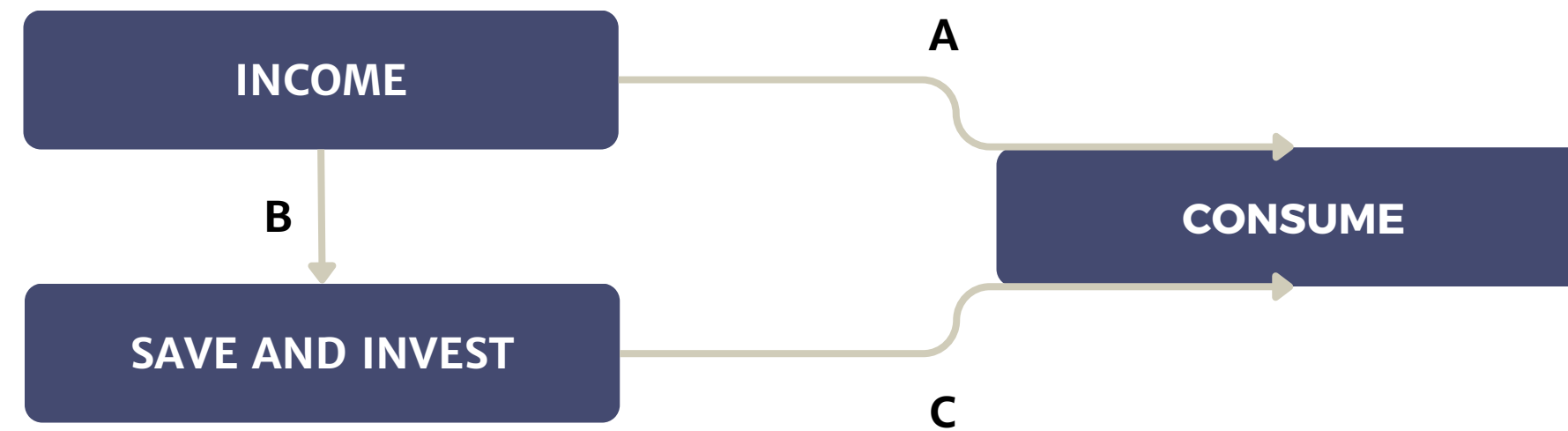
- Inflation rate fluctuated widely from 1999, reaching the peak value of 28.2% in August 2004 and later moderated.
- But inflation is now trending upward, ending 2022 at 21.3% and further rose to 25.8% in August 2023.
- Urban and rural inflation rates generally move together, except for the period between 2006 and 2012.
- In the last 2–3 years, urban inflation rates have been 1 percent point higher than rural on average.

DEGREE OF INFLATION IMPACT on Nigerian Households

- On average, Nigerians are estimated to allocate 50.71% of their expenditure to food, with 13.3% imported
- Other items with high proportion include utilities and fuel (16.73%), clothing and footwear (7.65%) and transport (6.51%).
- Inflation is relatively higher in food, transportation, health, restaurant and hotel, and utilities.
- An average Nigeria is most impacted from the food channel, including imported food, followed by utilities and fuel, transport and clothing.
- The lower the share of an individual's expenditure allocated to these items, and the more to communication, recreation, and alcohol, the less the inflation impact.

Consumption Classifications	Consumption Weights (%)	Inflation (%)	Average Impact	Impact Rating
Communication	0.68	7.74	0.05	Low Impact
Recreation & Culture.	0.69	10.40	0.07	
Alcoholic Beverage. Tobacco and Kola	1.09	15.34	0.17	
Restaurant & Hotels	1.21	22.77	0.28	
Miscellaneous Goods & Services	1.66	21.78	0.36	
Health	3.00	22.92	0.69	Medium Impact
Education	3.94	21.04	0.83	
Furnishings & Household Equipment Maintenance	5.03	16.52	0.83	
Clothing and Footwear	7.65	15.77	1.21	High Impact
Transport	6.51	27.10	1.76	
Imported Food	13.29	20.17	2.68	
Housing Water, Electricity. Gas and Other Fuel	16.73	21.79	3.65	
All Items less Farm Produce. and Energy	40.56	21.15	8.58	High Impact
All Items less Farm Produce.	51.31	21.54	11.05	
Food	50.71	29.34	14.88	
Food & Non Alcoholic Bev.	51.80	29.15	15.10	
All Items	100.00	25.80	25.80	

INCOME- SAVING (Investment) Relationship



A

Consume a Part of Your Today's Income Now

- The lower the proportion of income you consume now, the more you can save for future.
- The smaller your income, the more likely you are to exhaust it on basic needs and have nothing to invest.
- Inflation reduces purchasing power and what is available for savings.

B

Save and Invest Part of Your Today's Income

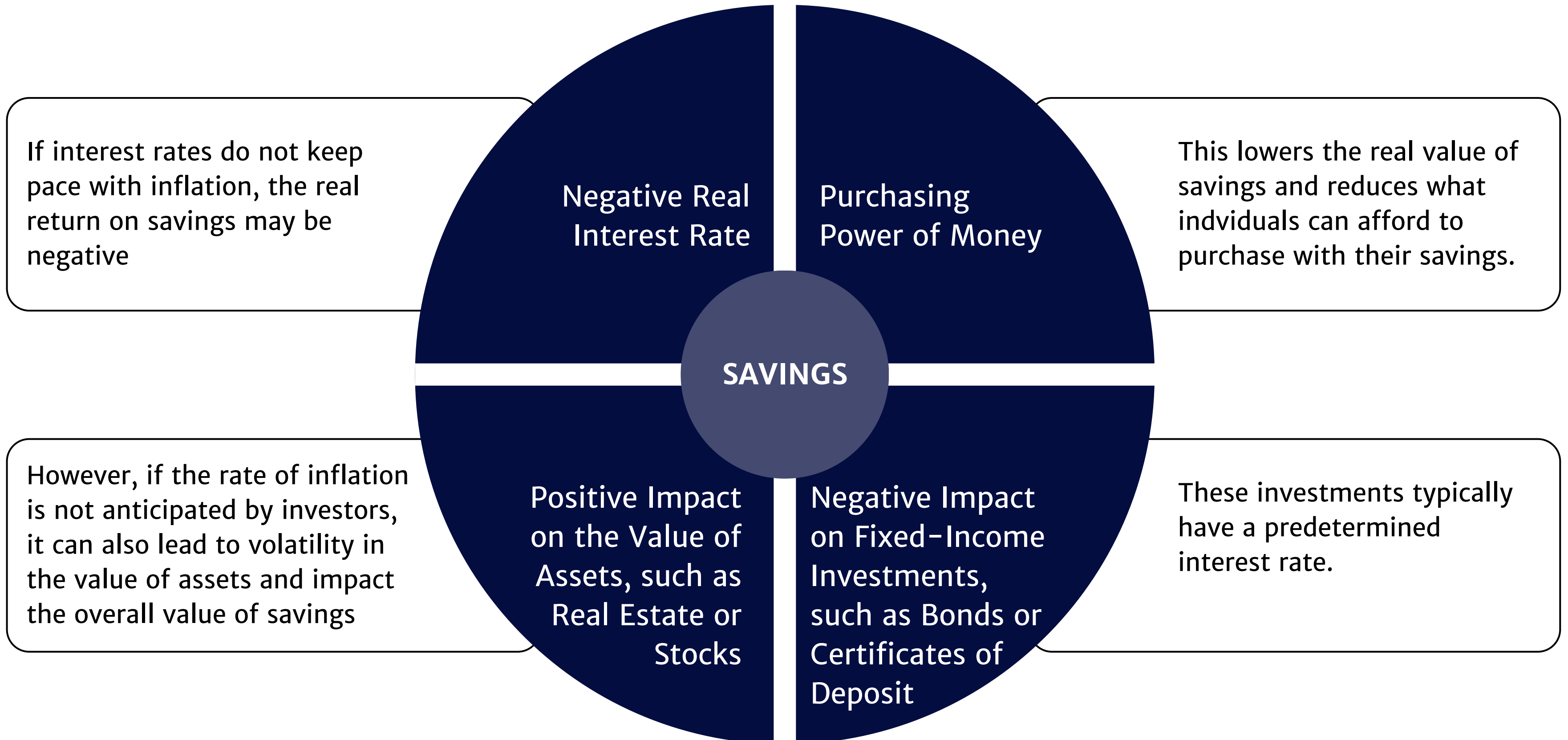
- Higher income enables savings and investment, since not all can be consumed now
- Expectation of higher rate of return and ability to forego current consumption also encourages savings
- Low to moderate inflation can encourage savings, but high inflation can encourage immediate consumption

C

Consume Your Savings + Returns in Future

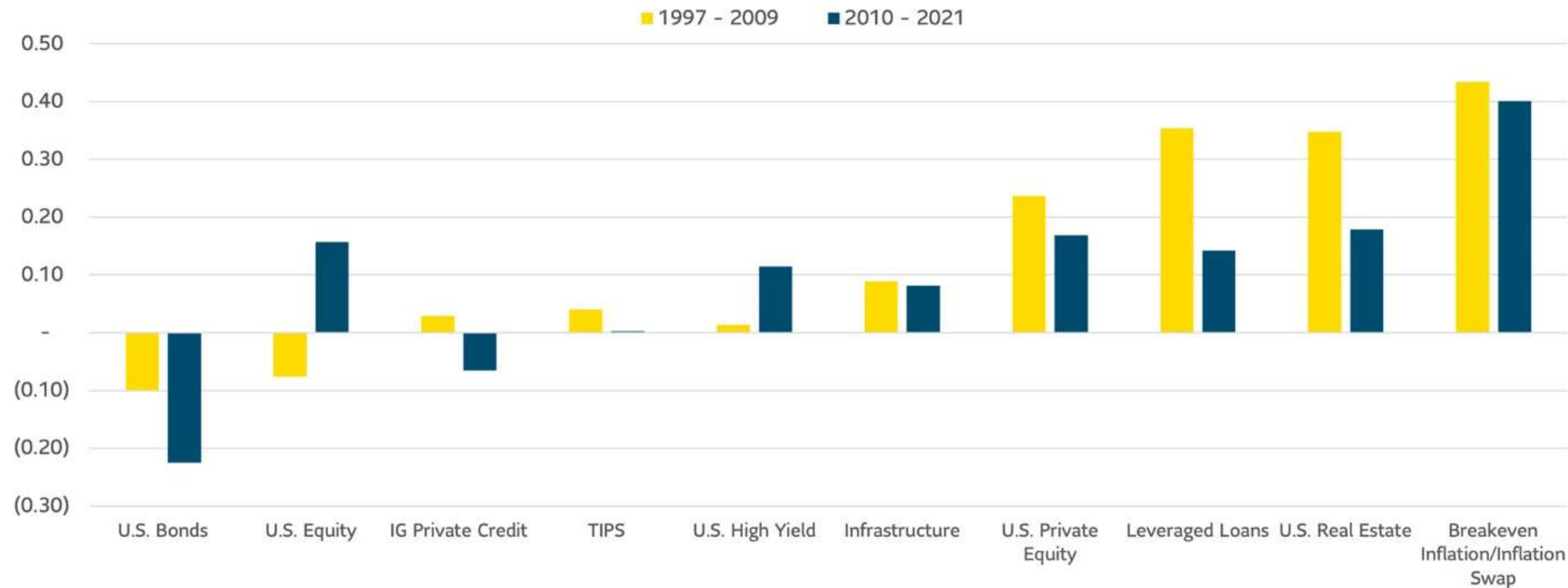
- Higher returns on investment make possible higher future consumption.
- But higher returns also correlate with higher risk and possibility of losing investment.
- Inflation is one of the risks, which can reduce the value of one's investment and constrain future expectations and consumption.

HOW INFLATION Impacts Saving



CORRELATION

Between US Inflation & Asset Returns



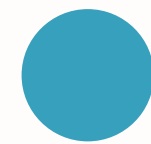
- Inflation swaps, Real Estate, Floating rate debts (leveraged loans) and PE have higher correlation
- Bonds are negatively related
- Equities in the last 10 years also positively related

INFLATION & INVESTMENTS

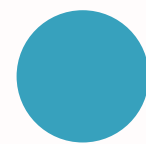
in Equities



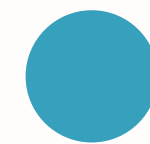
Low to moderate inflation is generally considered healthy for equities whereas high inflation is bad



Consumer demand is weaker during high inflation due to lower purchasing power

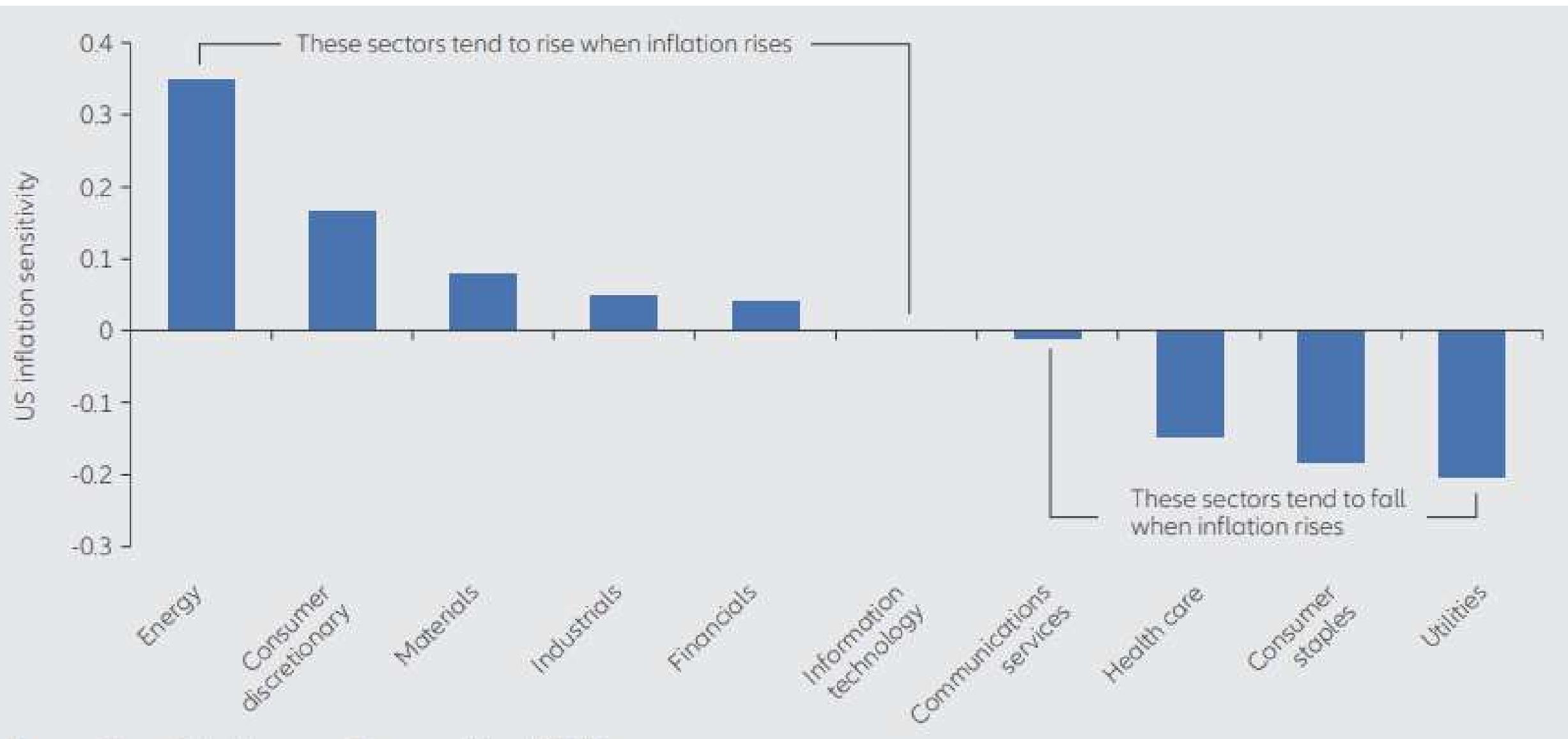


Also, rising raw materials costs lower corporates earnings, except they have pricing power and can transfer the costs to consumers.



Thus, the impact of inflation can vary by a company's and its sector's factors.

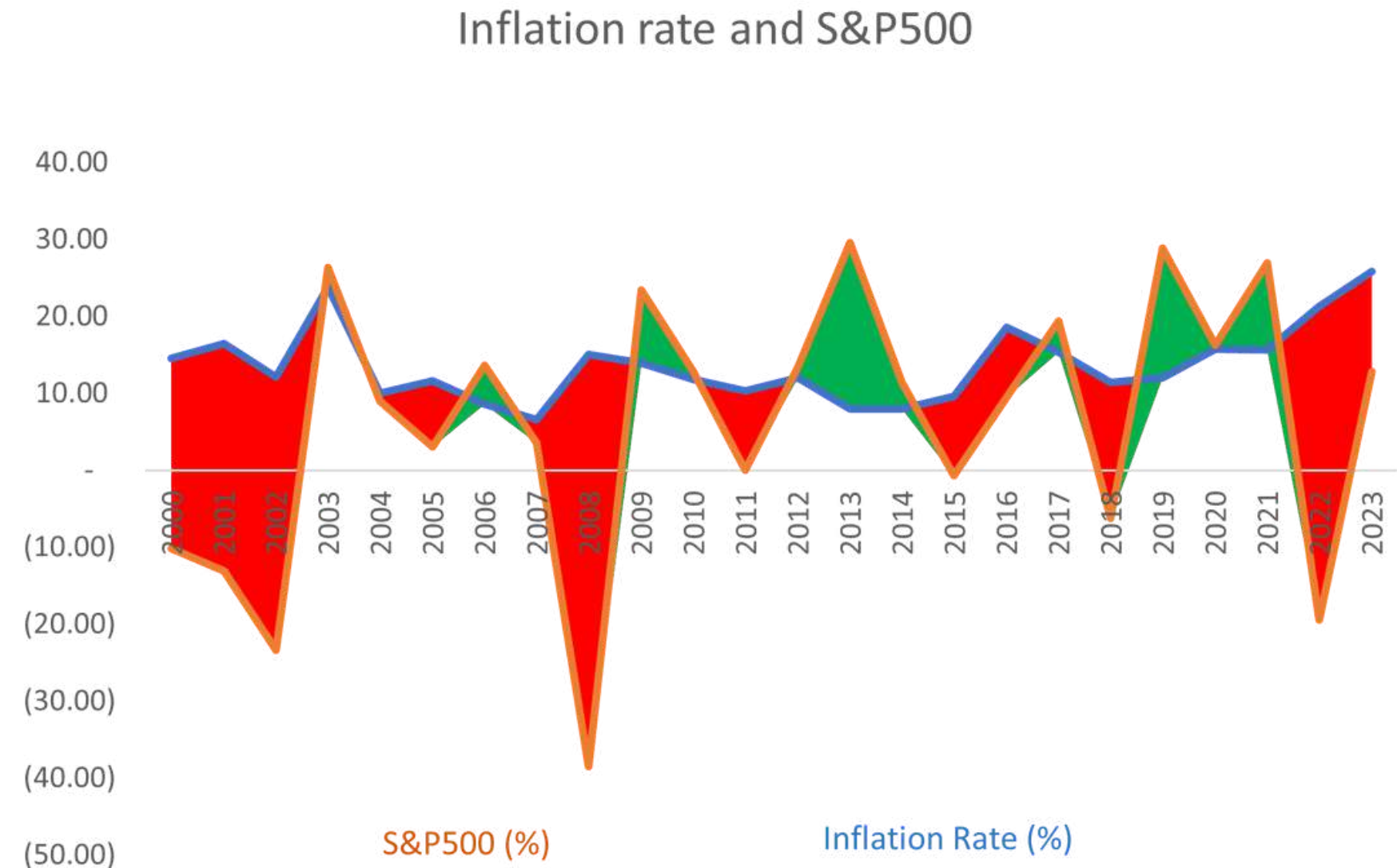
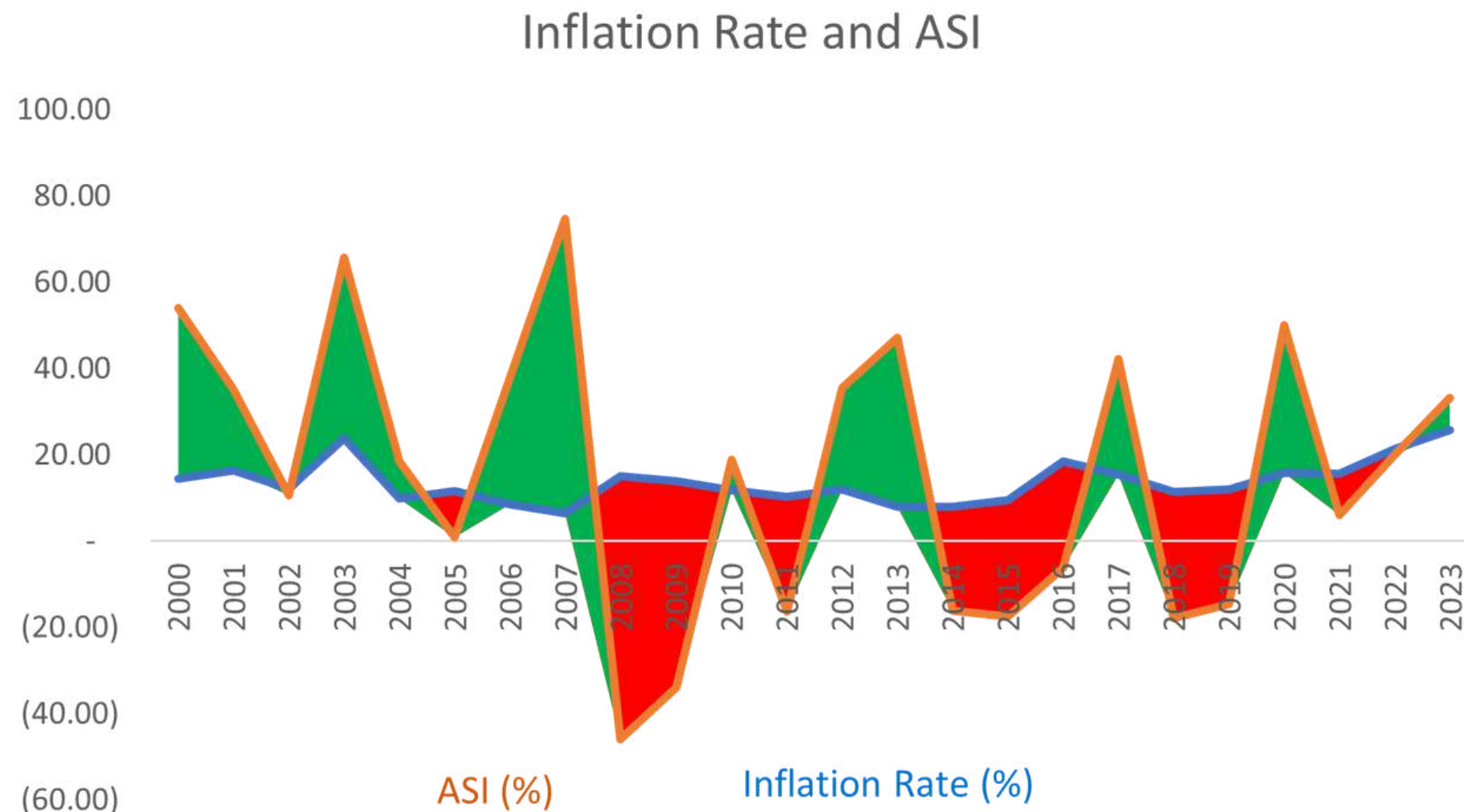
SECTOR'S CORRELATION with US Inflation



- Not all equities are the same
- Different sectors have responded differently to inflation
- Companies in sectors such as energy and materials that control physical assets and sell commodity-based products may gain during high inflation
- While companies in sectors like consumer staples and utilities that have commodities as major inputs will likely lose
- Even within a sector, some companies may be affected by inflation less if they can pass on their increased costs to consumers.

NIGERIAN INFLATION & Stocks Return

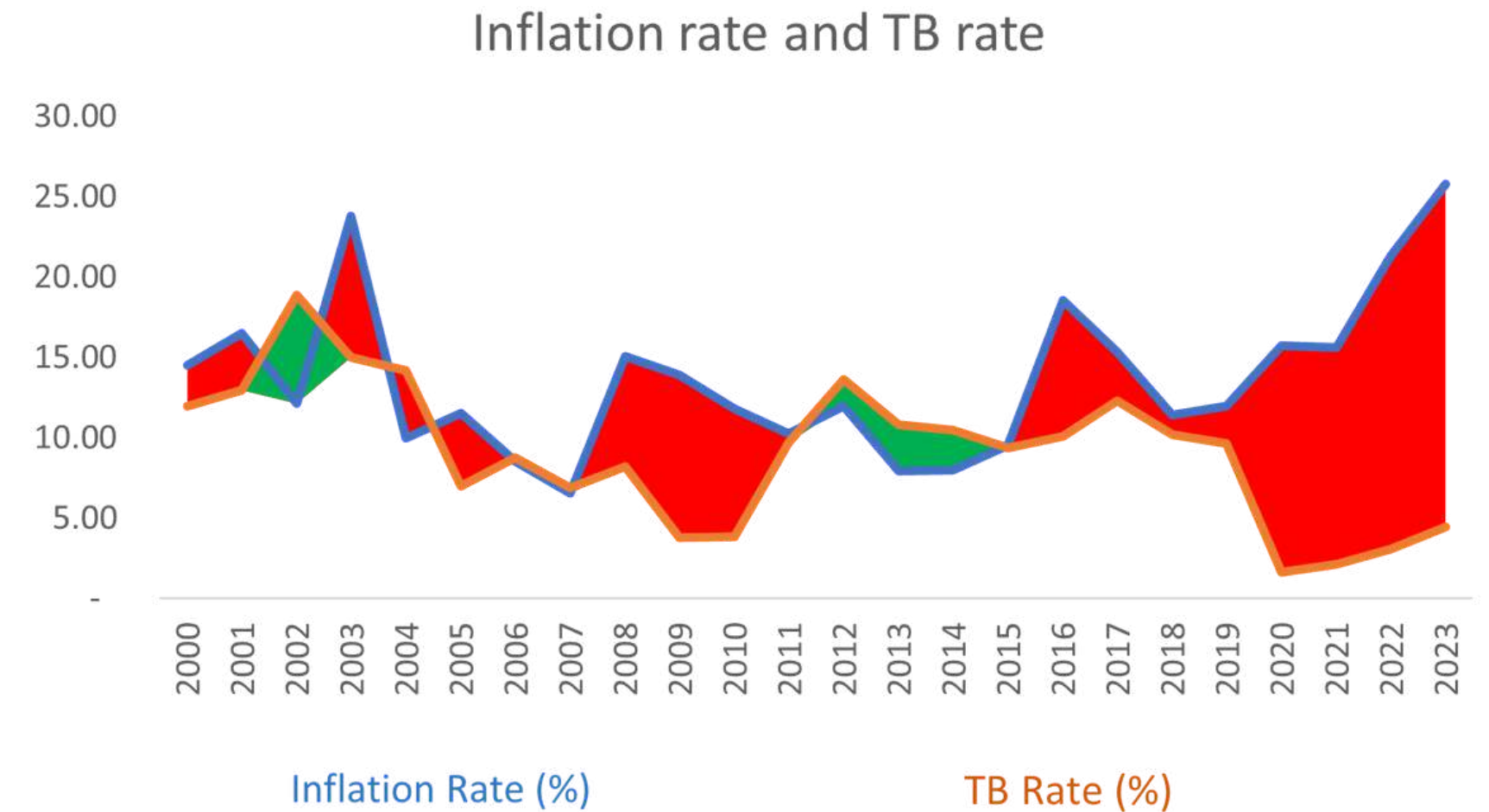
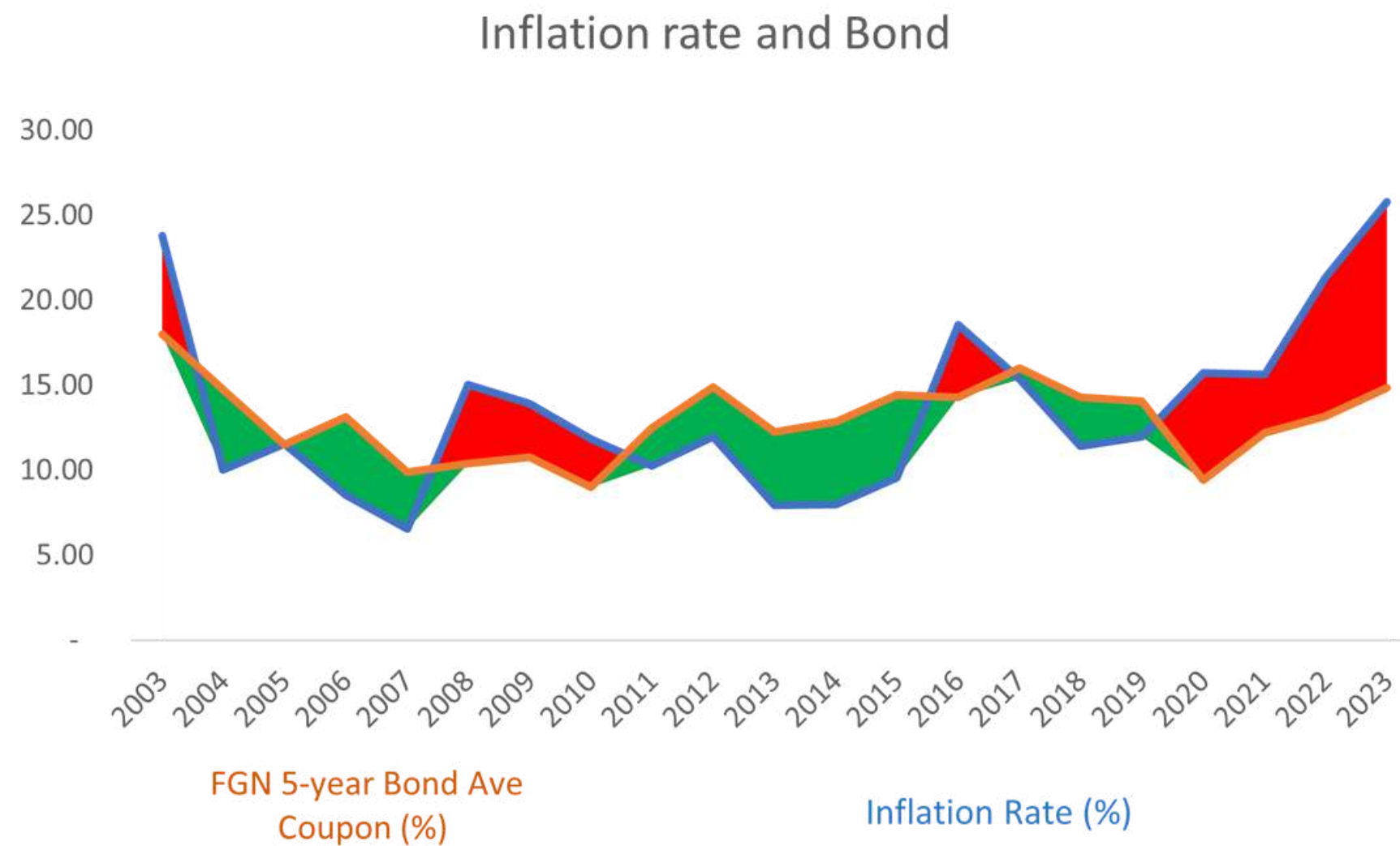
For 12 years ASI surpasses the inflation rate.



- Investment in foreign assets, e.g. S&P500 may also provide hedge in certain years,
- Especially when exchange gain is added

NIGERIAN INFLATION & Returns on Fixed Income Instruments

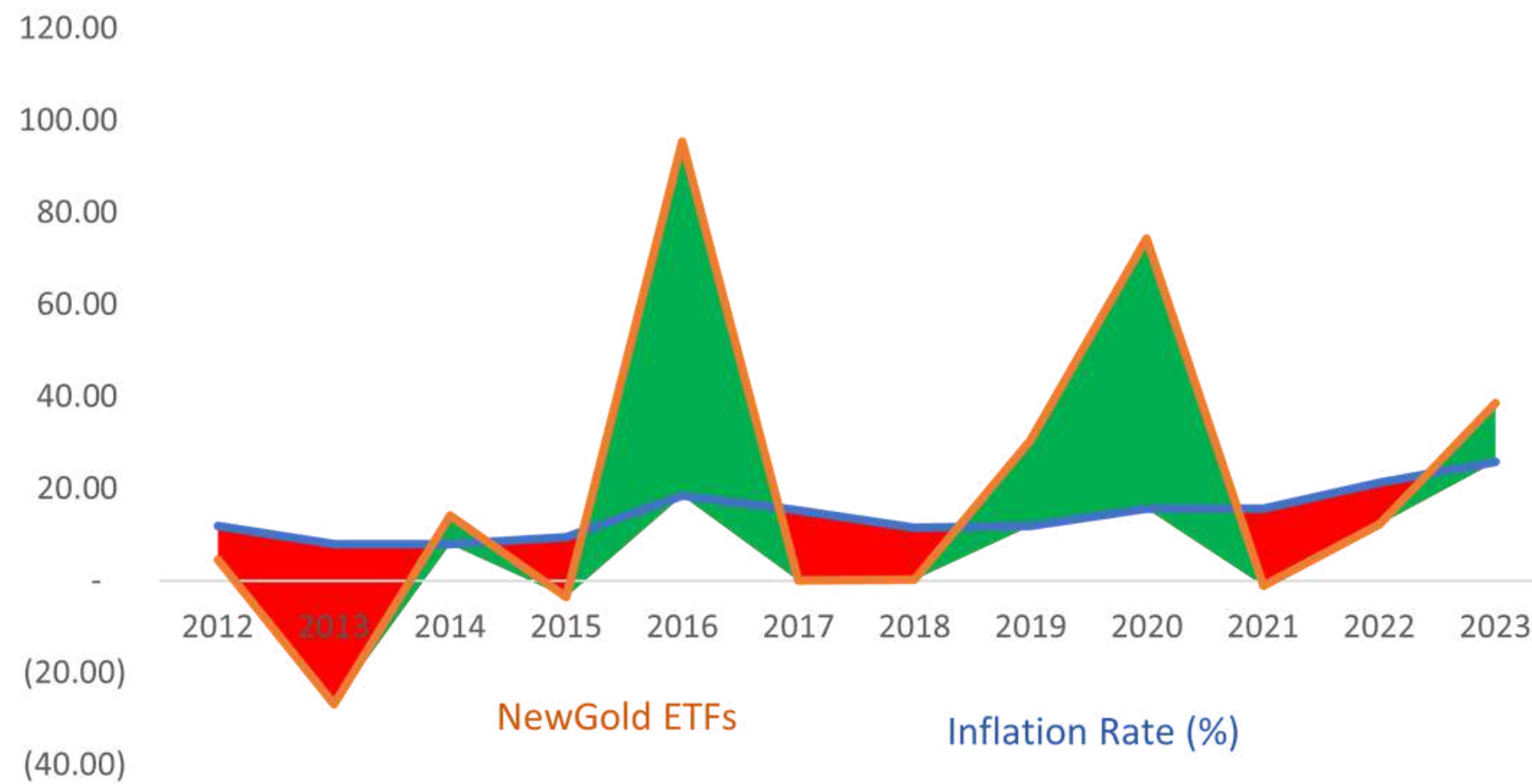
- From 2020 inflation rate remained higher than FGN 5-year Bond Ave Coupon



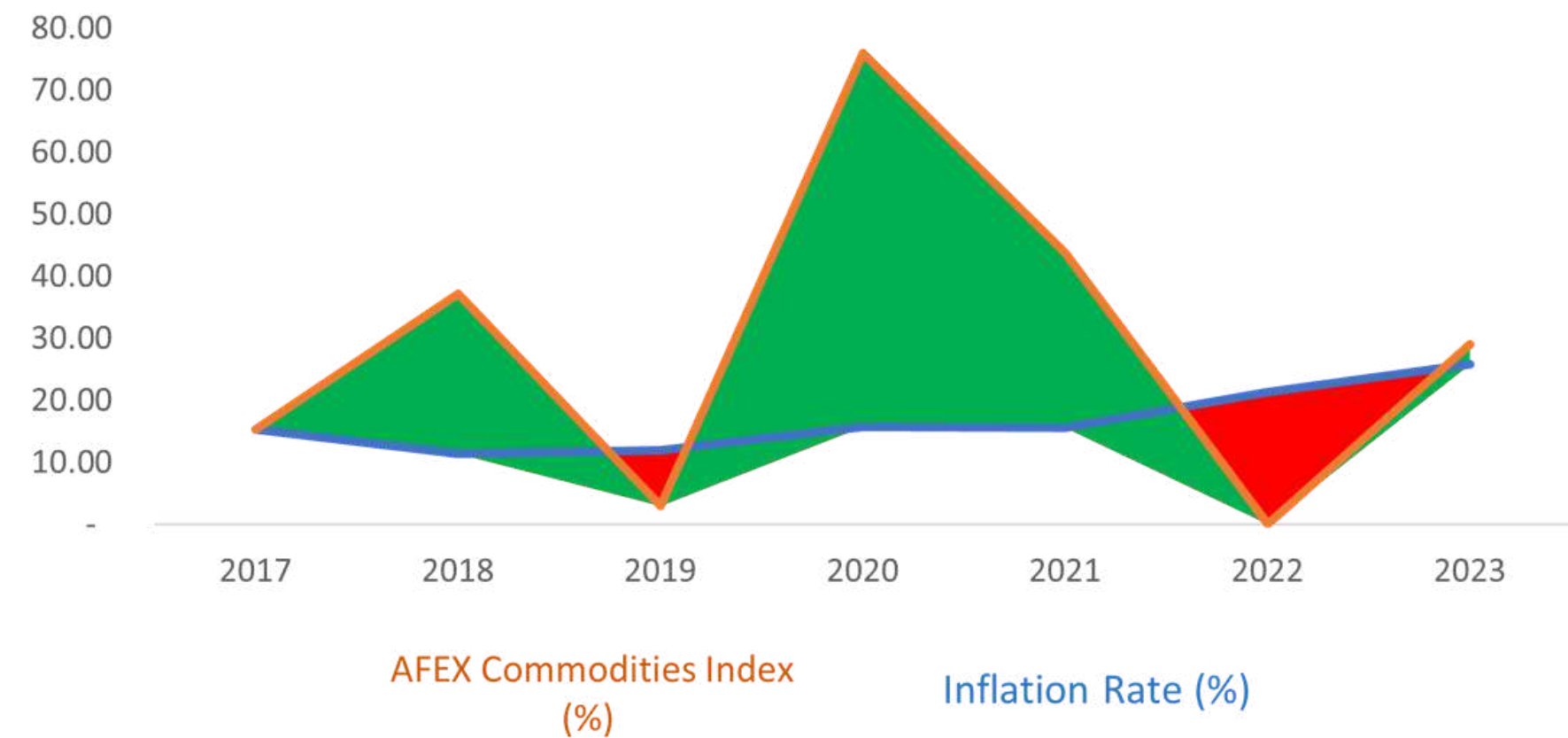
- Inflation rate remained higher than Treasury Bill rate since 2015

NIGERIAN INFLATION & Returns on Commodities

Inflation Rate and New Gold



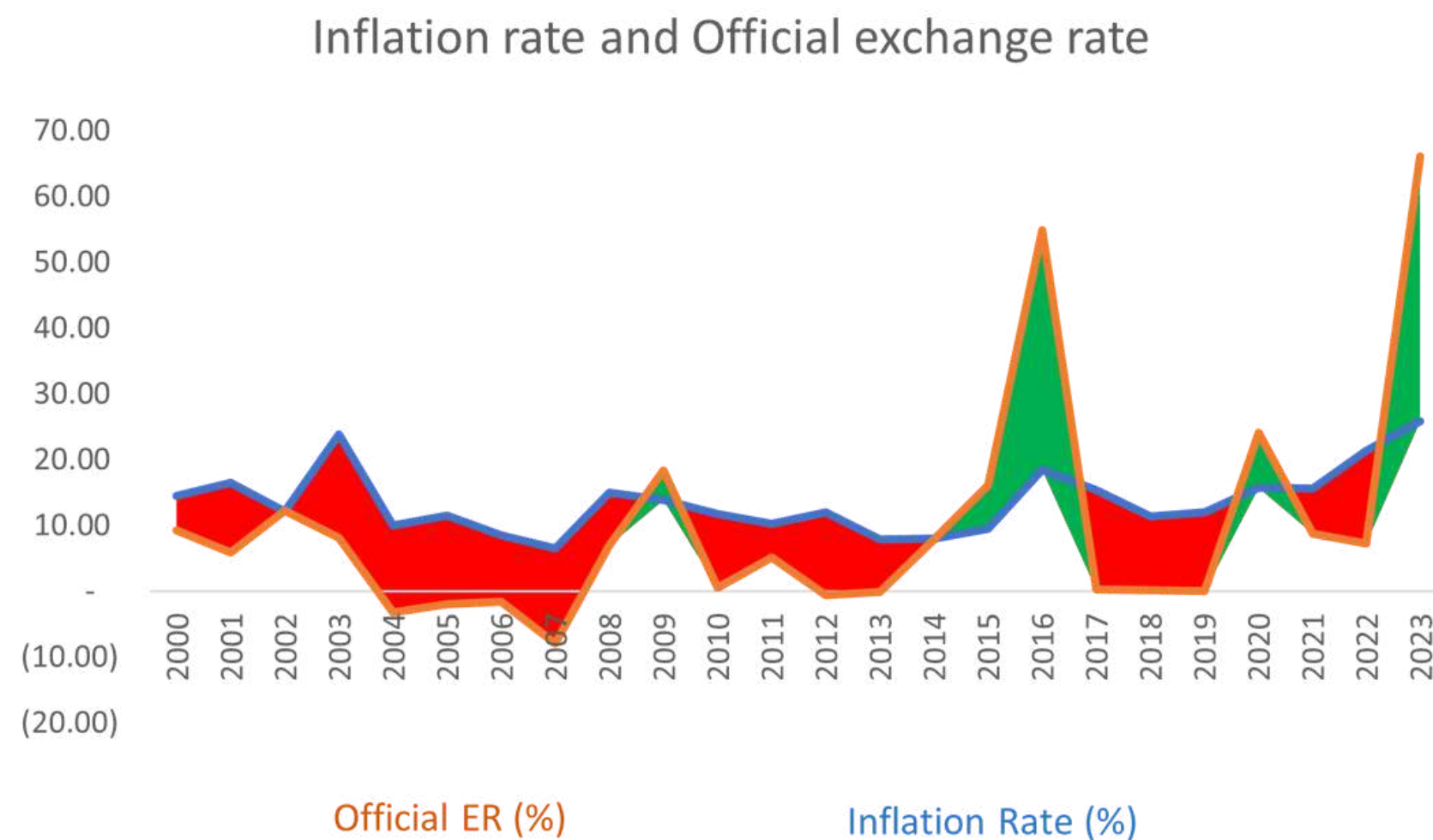
Inflation rate and AFEX



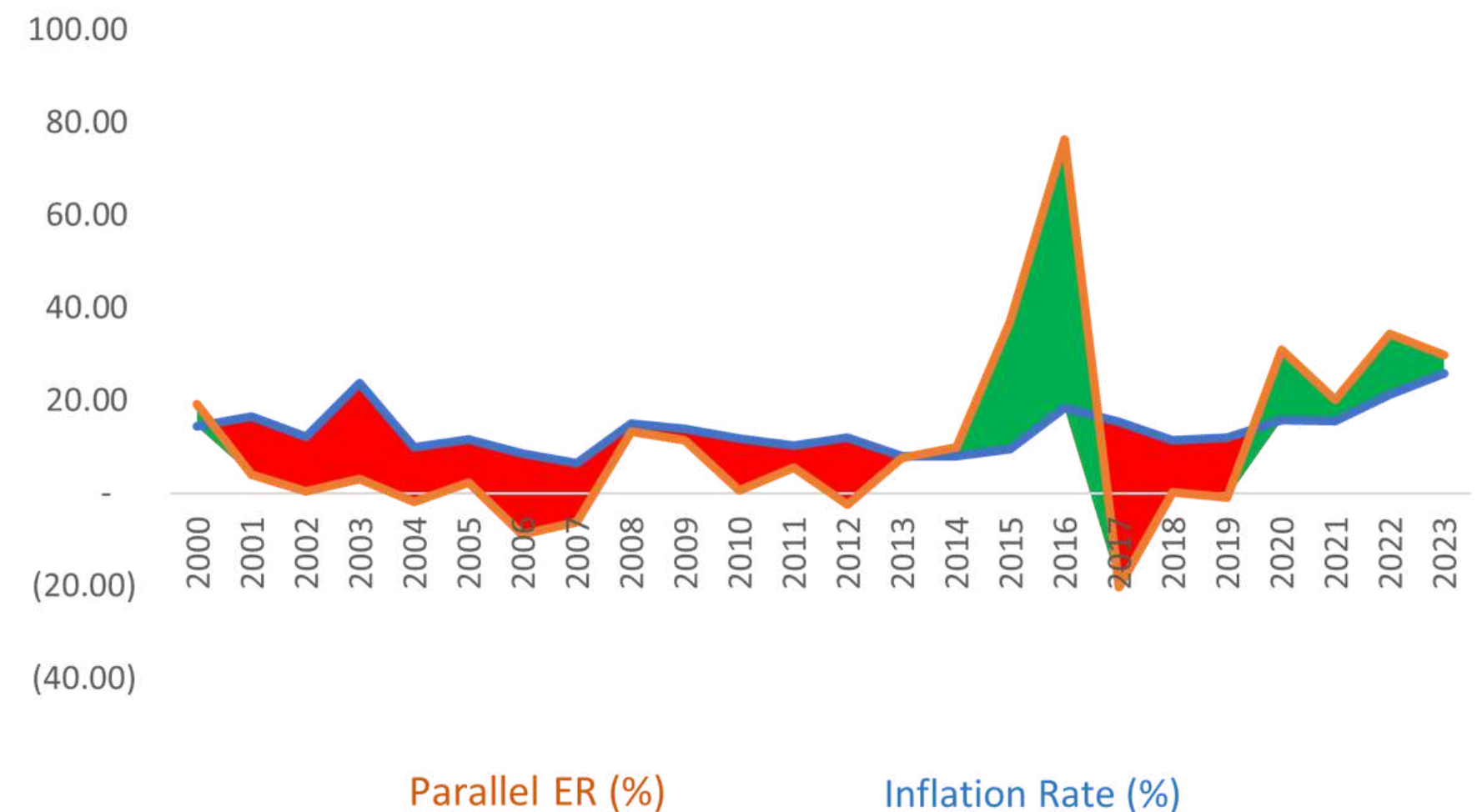
- Commodities, gold and agricultural, can provide some defence
- Some studies have shown that gold and commodities offered a better hedge than equities in the short-term (one year) against inflation, especially when unexpected,
 - although they come with higher volatilities than equities
- But over longer-term 5-20 years, equities are likely to give positive real return with lower risk than commodities.

NIGERIAN INFLATION & Returns on Dollar Savings

- Changes in Official rate (returns) in 2023 has been higher than inflation rate



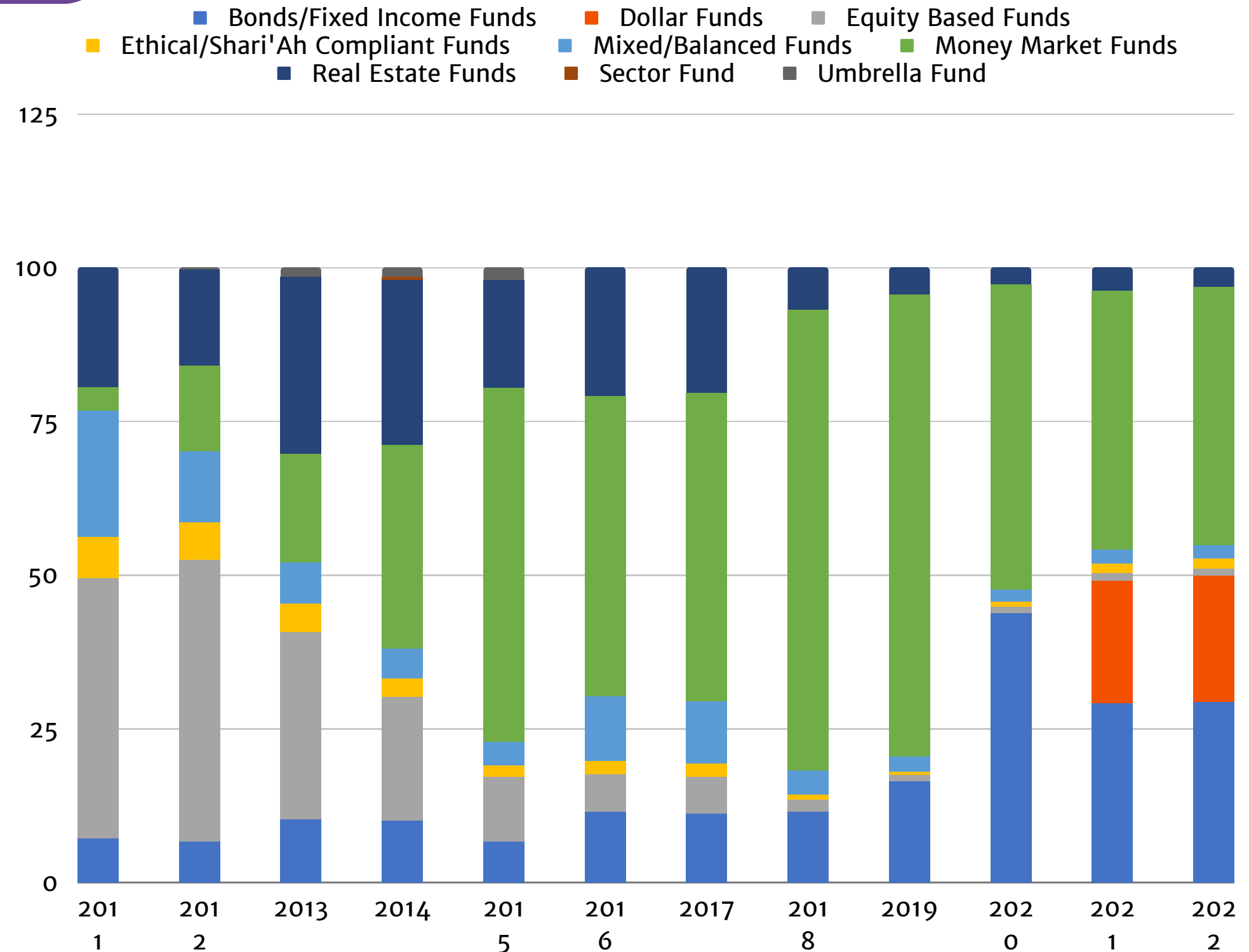
Inflation rate and Parallel Exchange rate



- Since 2020, returns on dollar savings, at parallel rate have remained higher than the inflation rate

STRUCTURE OF Collective Investment Schemes (CIS)

- Many CIS have gradually diversified from equities first to money market instruments, and then to bonds and other fixed-income instruments.
- Following the pandemic and foreign exchange challenges in the country, many of them now invest in dollar-denominated assets.



DEFENSIVE STRATEGIES

During Inflationary Periods

- Individuals may choose to diversify their source of income to supplement and counteract the effects of inflation.
- Consumers may alter their spending patterns by prioritizing essential items, actively comparing prices, hunting for discounts, and switching to cheaper alternatives to mitigate the impact of rising prices.
- Workers may negotiate for higher wages or seek better-paying job opportunities to keep up with the rising cost of living.
- Individuals tend to invest their money in assets such as stocks, real estate, or precious metals.
- Investors may reassess their portfolios and allocate funds to assets that tend to perform well during inflation.



SUMMARY

and Implications

- Do not consume all and be mindful of the inflation of items you allocate bulk of your income
 - Get more income to have savings and seek investments that can, at least, compensate for inflation
 - Think long-term, and diversify to preserve and grow savings/investment.
 - Consider your horizon and risk tolerance
 - Equities work with low to moderate inflation, and can also work for high inflation, especially over the long term
- Not all equities are the same, some companies and sectors can transfer a higher proportion of their increased costs to their customers, hence, a good hedge.
 - Commodities work for short term but can be more volatile
 - Given the relationship between exchange rate and inflation, some foreign-currency-denominated investments can also be good
 - Talk to experts for guidance



THANK YOU

For Listening

