momentum
investments

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in the moment

Inflation sinks to 3% in April 2020 under lockdown

Highlights

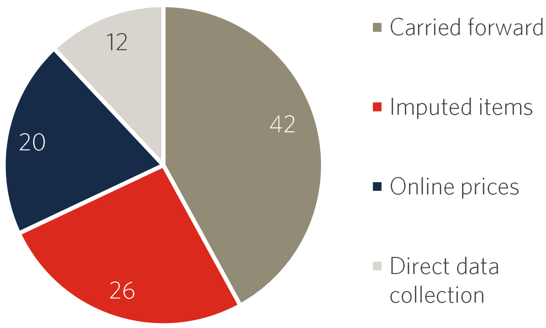
- Headline inflation dropped to 3% in April from 4.1% in March 2020 (published on 22 April 2020). This was broadly consistent with market expectations of 3.1%, as captured by Bloomberg.
- The release date for April's consumer price index (CPI) was delayed due to lockdown restrictions, limiting Statistics South Africa's (Stats SA) fieldwork used to collect survey data.
- In line with international best practice, Stats SA has used an imputed price methodology for items and services that were not available for sale during the lockdown. A quarter of the CPI weightings had to be calculated in this manner, while carry-forward prices were used for more than 40% of the basket items.
- While this method is deemed to be economically meaningful, it should be noted that the inflation number for April 2020 was based off a significantly smaller sample and this affected the regional breakdown.
- Stats SA is expected to publish May's inflation number in the middle of July 2020, while two thirds of its fieldworkers were active to collect June's prices, from when the normal methodology is expected to resume. The June number is likely to be released in July, closer in line to the original scheduled dates set prior to the lockdown.
- In our view, decimated demand and lower international oil prices should cap the rise in price pressures, leaving room for the SA Reserve Bank (Sarb) to ease interest rates by a modest 50 basis points in 2020.

COVID-19 lockdown restrictions posed survey challenges

Stats SA has faced notable survey challenges in recent months, as a result of government imposing lockdown restrictions, making it difficult to use normal survey methodologies, which involve the collection of data by fieldworkers.

In line with international best practice, Stats SA has introduced different methodologies to cater for the smaller sample size of prices of goods and services available for trade during the lockdown (see chart 1).

Chart 1: Methodology changes for April 2020 (%)



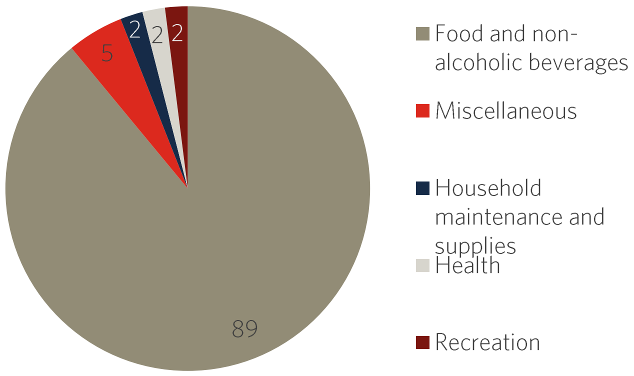
Source: Stats SA, Citi Research, Momentum Investments

The April 2020 survey methodology included:

- An imputed pricing methodology used for a quarter of the consumer basket (a headline CPI change will be calculated using available pricing information and the average change in this index will be applied to all indices for which no pricing data is available)
- Online price collection for a fifth of the basket (171 products)
- Prices for 41.5% of the basket items were not meant to be surveyed in April and these prices were carried forward as usual
- Prices for 12% of the basket (predominantly services) were collected directly

During April 2020, Stats SA ran a temporary project during level five of lockdown (from the week ending 2 April 2020 to 30 April 2020), where the prices of essential goods and services were calculated. This essential products basket comprised 20% of the weighting of the overall CPI basket (187 products out of a total of 412 products). Nearly 90% of the essential products basket was related to the prices of food and non-alcoholic beverages (see chart 2). While the essential products basket showed mild deflation in April 2020, Stats SA noted the computation methods differed from the way in which the April 2020 CPI number would be calibrated. Nonetheless, the essential products basket indicated a slowdown in the April 2020 inflation figure would be forthcoming.

Chart 2: Essential products CPI (%)



Source: Stats SA, Citi Research, Momentum Investments

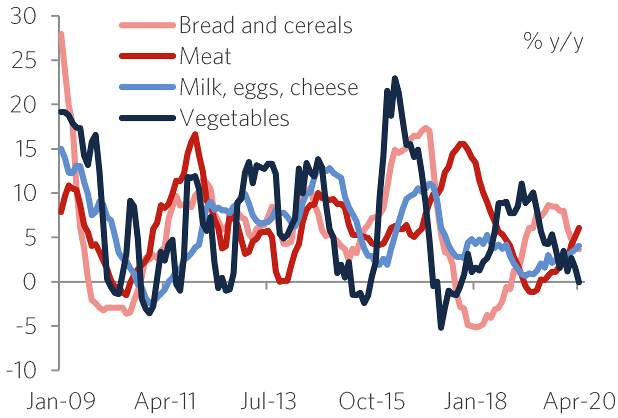
Imputed methodologies are likely to be used for the May 2020 inflation number, given the continuation of lockdown restrictions preventing normal activity by fieldworkers. As a result of the methodologies applied, the May CPI figure will likely only be available around the middle of July 2020 (the date has not yet been confirmed by Stats SA).

The inflation number for June 2020, however, may be published closer to its original scheduled date at the end of July 2020, as two thirds of Stats SA's fieldworkers were deployed for data collection in June 2020, which will result in some normalisation of the methodology behind the inflation figures.

Food inflation likely to remain subdued in the near term

Bread and cereal inflation shifted lower to 3.7% year on year (y/y) in April 2020, from 3.8% a month earlier (see chart 3). The Agricultural Business Chamber (Agbiz) highlighted SA's 2020/21 wheat production season was underway. Plantings have been completed in the Western Cape and the recent weather conditions paint a favourable picture for wheat production. While many grain-producing countries were considering restrictive trade policies at the start of the pandemic when fears about grain shortages were high, Agbiz does not see this as necessary going forward, given large supplies from the 2019/20 season and a promising outlook for the 2020/21 production levels.

Chart 3: Food inflation by category



Source: Stats SA, Global Insight, Momentum Investments

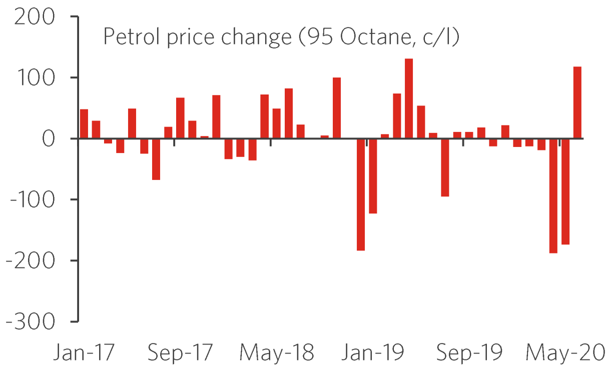
Meat prices inched higher to 6.1% y/y from a trough of negative 1.2% y/y in April 2019, when the ban on red meat, due to a foot-and-mouth outbreak, suppressed meat prices. Although meat prices are coming off a low base, depressed household incomes may limit the rise in meat inflation in the coming months.

According to Agbiz, most of SA's agricultural and food sector was operational under the strict level five lockdown period, with the exception of the wine, floriculture, wool and cotton subsectors. Agbiz notes food price inflation is expected to be subdued for the remainder of the year (specifically grains and fruit) and, as a result, sees an average food inflation rate of 4% for 2020 from 3.1% in 2019, largely underpinned by higher meat and poultry (due to a recent tariff adjustment) prices.

Sizeable petrol price cut in April and May 2020

Petrol prices were cut by R2.44c/l (95 Octane) between March and June 2020 (see chart 4), but a current over-recovery between 29 May and 22 June 2020 calculated by the Central Energy Fund (CEF) suggests an increase of 169c/l could be possible for July 2020, given the upward move in international oil prices during the month.

Chart 4: Petrol price changes



Source: CEF, Momentum Investments, data up to June 2020

The international price of oil peaked at US$69/bbl in early January 2020, bottomed below US$20/bbl in late April 2020 and ticked up to above US$40/bbl since. The International Energy Agency (IEA) suggested the easing of lockdown measures in many countries should provide a boost to the international demand for oil in the second half of the year, but even so, demand is likely to be 8.1 million barrels per day lower than in 2019. While some recovery is pencilled in for 2020, the IEA sees global oil demand at 2.4 million barrels a day lower in 2021 relative the level experienced in 2019.

Inflation in the transport category decreased by 4.1% between March and April 2020 and dropped by 3.5% relative to a year ago. Within the transport category (which accounts for 14.3% of the total consumer basket) private transport (largely fuel costs) dropped to negative 12.8% y/y in April 2020 and dipped by 11.1% relative to the prior month. The monthly drop in transport inflation was predominantly responsible for the 0.5% monthly decline in the headline inflation number in April 2020.

Imputation methods have affected the interpretation of the core inflation measure

Stats SA warned the imputation methods deployed to calculate the inflation figure for April 2020 have diminished the meaning of the core inflation number, as items not generally included would have been used to impute a core inflation result.

Core or underlying inflation dropped to 3.2% y/y from 3.7% a month earlier, showing a 0.2% dip in monthly terms. Rental inflation, which is a significant component of services and core inflation, will only be surveyed in June 2020, in line with its usual quarterly survey. In our view, depressed household incomes are expected to exert downward pressure on rental prices for the remainder of the year.

Room for modest monetary policy easing from here

In a speech to the Wits School of Governance on 18 June 2020, the Sarb governor reviewed all actions taken by the central bank to date since the start of the year which included:

- A lowering of interest rates by 275 basis points (in comparison to the median emerging market move of 100 basis points)
- Making liquidity abundantly available to banks through a range of facilities
- Providing regulatory relief to the financial sector to sustain the flow of credit to households and corporates
- Providing funding for small and medium enterprises through the loan guarantee scheme (starting at R100 billion, but with the option of scaling up to R200 billion if there is appetite)
- Purchasing bonds in the secondary market (0.6% of gross domestic product) to improve the functioning of fixed income markets

In the speech, the Sarb reiterated symmetric price stability mandates are used by modern central banks. As a result, central banks aim to avoid too high inflation and too low inflation.

In SA's case, we expect inflation to fall to the 2% mark on suppressed demand in the COVID-19 crisis. Moreover, we anticipate an economic contraction of about 8% in 2020 and only expect a mild growth recovery to 2% in 2021. While we are aware of fiscal policy decisions and a high debt burden in SA having a bearing on monetary policy decisions, we think there is space for a modest 50 basis points of easing in the repo rate in light of depressed growth and a breach of the inflation target to the downside, given that our inflation component checklist is largely dominated by disinflationary pressures in the short term (see table 1).

Although wage and rental prices are likely to pick up in the medium term (indicated by the red upward arrows), inflation in these categories are likely to remain well below long-term averages in light of soft domestic demand.

The first-quarter-growth number (due to be released at the end of June 2020) will likely also provide a critical input in the July 2020 monetary policy decision.

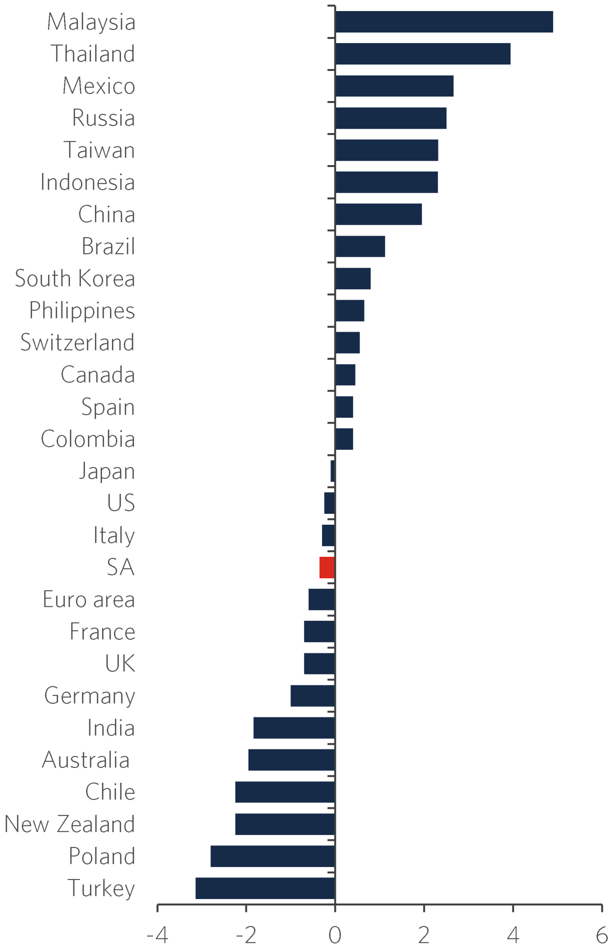
Table 1: Inflation component checklist dominated by disinflationary pressures in the short term

Inflation component	Short term	Medium term
Food	↓	→
Energy	↓	→
Wage growth	↓	↑
Rental prices	↓	↑
Imported prices	↓	↑
Administered prices	↑	↑
Output gap	↓	↓
Credit growth	→	→
Inflation expectations	↓	→

Source: RMB, Momentum Investments

This suggests SA's real interest rate (based on realised inflation rather than forecasted inflation a year ahead) could trend in mildly negative territory for a short period (see chart 5).

Chart 5: Real interest rate comparative (%)



Source: Stats SA, Bloomberg, Momentum Investments