momentum
investments

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moment

Utility tariff increases push headline inflation back into the bottom edge of the 3% to 6% target

Highlights

- Headline inflation crept back into the lower end of the 3% to 6% inflation target range in July 2020. Utility tariff increases urged inflation higher to 3.2%.
- The headline and core inflation figures were slightly above the Reuters consensus forecasts of 3.1% and 3%, respectively. Core inflation surprised to the upside at 3.2% in July 2020 and increased by 0.7% in the month.
- Although lockdown restrictions limited Statistics South Africa's (Stats SA) fieldwork used to collect survey data in earlier months, Stats SA has resumed its normal schedule and the use of its regular statistical methodologies. The gross domestic product reading for the second quarter of the year will be published by Stats SA on 8 September 2020, while the August 2020 consumer inflation number will be printed on 30 September 2020.
- The electricity price index increased by 6.2% month on month (m/m) in July 2020, broadly in line with the energy regulator's Eskom Retail Tariff and Structural Adjustment (Ertsa) determination.
- In our view, decimated demand and anchored inflation expectations leave room for the SA Reserve Bank (Sarb) to ease interest rates by another 25 basis points in 2020.

Headline inflation inches higher on petrol price increase and electricity tariffs

Stats SA has resumed its regular reporting schedule on inflation releases as fieldworkers are now able to carry out surveys with fewer restrictions that were applied during more stringent levels of lockdown.

Headline inflation rose from 2.2% in June 2020 to 3.2% year on year (y/y) in July, coming in slightly above the Reuters expectation of an increase to 3.1%. The 1.3% m/m increase in headline inflation was largely driven by transport and utility costs.

Private transport costs rose 9.7% in the month due to a 172c/l increase in the petrol price according to the Central Energy Fund. Meanwhile, public transport costs increased by 2.5% in the month.

Within the housing and utilities category, electricity prices increased by 6.2% m/m in July 2020 (see table 1), broadly in line with the Ertsa determination. We are pencilling in an electricity price increase of 15% for 2021, which is higher than the SA Reserve Bank's (Sarb) assumption of 6.7% for 2021. The Sarb included an electricity price estimate of 9.6% for 2020.

Relative to our forecasts, price increases in the alcoholic beverages (1.2% m/m), tobacco (1.3% m/m), public transport (2.5%), hotels (1.2% m/m), vehicles (1.3% m/m) and other services (which includes funeral costs, 7.5% m/m) categories surprised to the upside.

Table 1: Historical electricity price increases in July (% m/m)

2008	22.6
2009	21.5
2010	16.1
2011	15.9
2012	8.8
2013	7.0
2014	6.9
2015	11.2
2016	7.4
2017	2.0
2018	6.7
2019	10.3
2020	6.2

Source: Global Insight, Momentum Investments

Food price pressures to be limited by constrained consumer finances

Food inflation rose by a marginal 0.1% in July 2020 to 4.6%, mainly driven by the rise in processed food prices. Prices of fish (1.3% m/m), vegetables (0.9% m/m) and bread and cereals (0.4% m/m) drove food inflation higher, while prices for sugar/desserts and oils and fats slipped in the month.

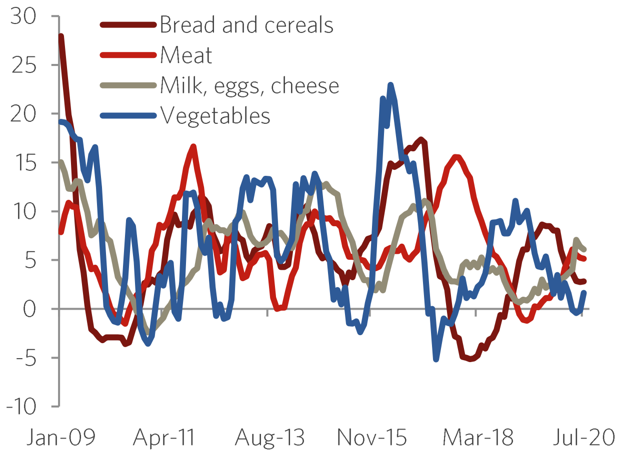
According to the Agricultural Business Chamber (Agbiz), commodity prices for the 2019/2020 harvest are surprisingly high for a year when there is a bumper crop. Agbiz acknowledges that strong demand from the Southern Africa region and deep-sea markets, delay in maize deliveries due to the late start to the season and currency weakness have all contributed to this trend.

Nonetheless, Agbiz admits job and income losses among consumers will prevent retailers from easily passing on these cost increases.

Before the COVID-19 pandemic struck SA, 19 locations had been identified with an outbreak of Foot and Mouth Disease, which had affected SA's export of beef. In August 2020, it was reported that the quarantine was lifted in nine of these regions, which should help boost exports in the coming months. Agbiz noted beef exports contributed US$140 million towards SA's agricultural exports of US$10.6 billion in 2018 and the sector employs at least half a million people.

In the local market, restaurant closures and pressure on household incomes are likely to contain beef prices.

Chart 1: Food inflation trends (% y/y)



Source: Global Insight, Momentum Investments

The hurdle is rising to cutting interest rates significantly from here

In our opinion, the Sarb acted swiftly and decisively in the COVID-19 crisis. The Sarb lowered rates by 300 basis points since the start of the year, while also providing regulatory relief to the financial sector to sustain the flow of credit to households and corporates. It has also provided funding for small and medium enterprises through the loan guarantee scheme and aided the smooth functioning of fixed income markets by purchasing bonds in the secondary market.

Sluggish growth in credit in the private sector continues to suggest that it is too early to calculate the effects of the interest rate cuts on the economy as yet, but this may become increasingly evident as lockdown restrictions ease further.

Treasury and the Banking Association of SA provided an update of the loan guarantee scheme, which similarly reflects a slow and reluctant uptake of credit in the current poor economic environment. At 1 August 2020, the scheme lent out R14 billion (of an initial R100 billion which can be ramped up to R200 billion), which has benefited 10 000 firms. A number of changes (including an extension to interest and capital repayment holidays, the duration of the loans, an easier test for good standing, an inclusion for sole proprietorships and less restrictive loan approvals and bank credit assessments) have been made to encourage a greater take up of the scheme.

The Sarb's purchases of government bonds slowed further in July 2020 to R2.2 billion. In our view, this is an indication that relative stability has returned to fixed income markets and the Sarb has been successful in restarting price discovery and encouraging the entry of private sector participants, while still adhering to a credible inflation-targeting mandate.

The Sarb's decision on interest rates on 17 September 2020 will likely consider the extent of the contraction in economic growth in the second quarter of the year (the August 2020 Reuters Econometer pegs the median growth estimate at negative 44.5% quarter on quarter seasonally adjusted, q/q saar) but also the strength and sustainability of the expected recovery in the second half of the year. The August 2020 Reuters Econometer forecasts a median quarterly growth estimate of 18.6% q/q saar for the third quarter of the year and 6.1% q/q saar for the final quarter of the year.

In our view, we expect growth to contract by 8.1% this year, broadly in line with the August 2020 Reuters consensus but expect a shallower recovery in growth of around 2% next year (relative to the median expectation of 3.1%) given constrained power supply and muted confidence levels.

We expect inflation to average 3.1% in 2020 before climbing to 3.6% in 2021. Inflation expectations are likely to remain well behaved in an environment of supressed economic activity, allowing for room for the Sarb to ease interest rates marginally further, in our view. We see scope for another 25 basis points of easing in the repo rate in the coming months in light of depressed growth and subdued inflation.