momentum
investments

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in the moment

Inflation profile little changed on reweighting exercise

Highlights

- SA headline inflation dropped back to 5.7% year-on-year (y/y) in January 2022 from 5.9% y/y in December 2021 and was in line with the Reuters consensus.
- The monthly 0.2% increase in headline inflation was largely driven by increases in food prices (oils and fat, vegetables and meat) and financial services (including banking charges) costs.
- Capital Economics suggests that attacks on fuel storage facilities in the United Arab Emirates, related conflict in Yemen and rising fears of a Russian invasion of Ukraine have added around US$30/bbl to international oil prices by means of a risk premium related to geopolitical concerns. While the current spike in international oil prices is viewed as a temporary shock, it remains one of the key upside risks to local inflation, in our view.
- Underlying measures of inflation, including the trimmed mean and core inflation, remain considerably lower than the headline measure of inflation, indicating weaker underlying inflation pressures in the economy and highlighting the effect of commodity prices on the headline reading.
- International standards require a reweighting of the consumer price index (CPI) every five years to reflect changing tastes, new products and services and to account for the substitution bias, under which households turn to cheaper substitutes.
- Partly in the absence of a full income and expenditure survey (due to expenditure constraints faced by Statistics South Africa (Stats SA)), the changes have been quite small this time around and make a marginal difference to our expected inflation profile. We expect headline inflation to average 4.9% in 2022, 4.3% in 2023 and 4.3% in 2024. On core inflation, we project an average of 3.6% for 2022, 3.9% in 2023 and 4.1% in 2024.
- The January 2022 inflation figure does not derail our view on monetary policy moves for the remainder of the year. We continue to forecast a further three hikes of 25 basis points each for 2022, with the repo rate reaching a terminal value of 5.75% in early 2024.

Update of the CPI weights and basket

International standards require a reweighting of the inflation basket every five years to reflect changing tastes, new products and services and to account for the substitution bias, under which households turn to cheaper substitutes.

Due to expenditure constraints faced by Stats SA, the statistical body was unable to run a full income and expenditure survey to accurately reflect these changes. Instead, they used annual national accounts data, which does not have the same level of product detail and only provides national estimates. Nonetheless, Stats SA increased the accuracy of the exercise using data from retailers and it applied the previous proportions for the lower level and provincial detail.

Stats SA noted the importance of weights having to reflect current expenditure patterns, but periods where spending patterns change temporarily should also be avoided. An example of this would be the shift in consumer spending patterns on hotels, restaurants, alcoholic beverages, transport and data usage during the COVID-19 pandemic.

The current reweighting exercise has yielded smaller differences in projected inflation than in previous rounds. Stats SA warns that while they have taken measures to improve the accuracy of the data this time around, in the absence of a full income and expenditure survey, a lack of funding poses risks to data accuracy in the longer term.

The number of products in the basket has increased from 393 in 2012 to 404 in 2016 and 415 in the latest reweighting exercise. Fourteen new items were included in the basket, including dairy/fruit juice blends, pureed baby food, jam, samp, cappuccino sachets, gin, floor and wall tiles, fabric softener, printer paper, sound bars, printer cartridges, wipes, razors and foundation makeup. Two items (DVD players and satellite dishes) were tossed out and some products were combined into single categories (super and special maize meal, traditional and energy-saver lightbulbs, streaming music and CDs and wireless and wired internet usage). The biggest change in consumer basket weights has arisen in the alcoholic beverages and tobacco category (see table 1).

Table 1: High level inflation category weights

High level inflation categories	2012	2016	2019
Food and non-alcoholic beverages	15.41	17.24	17.14
Alcoholic beverages and tobacco	5.43	5.82	6.26
Clothing and footwear	4.07	3.83	3.65
Housing and utilities	24.52	24.62	24.49
Household contents	4.79	4.35	4.37
Health	1.46	1.4	1.44
Transport	16.43	14.28	14.35
Communication	2.63	2.63	2.42
Recreation and culture	4.09	5.16	5.2
Education	2.95	2.53	2.62
Restaurants and hotels	3.5	3.09	3.25
Miscellaneous goods and services	14.72	15.05	14.81

Source: Stats SA, Momentum Investments
Red = increase in weighting between 2016 and 2019
Green = decrease in weighting between 2016 and 2019

No surprises in the January 2022 inflation figure

SA headline inflation dropped back to 5.7% in January 2022 from 5.9% y/y in December 2021 and was in line with the Reuters consensus. The monthly 0.2% increase was largely driven by increases in food (oils and fat, vegetables and meat) prices and financial services (including banking charges) costs.

Relative to our forecasts, price increases in food, household appliances, domestic worker wages and hotels surprised to the upside, while public transport inflation surprised to the downside.

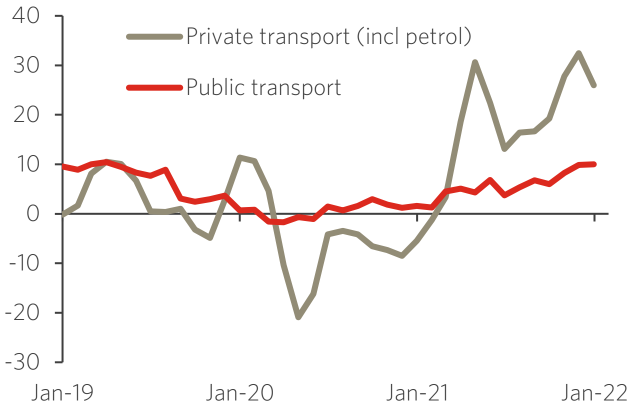
Public transport inflation (which largely reflects taxi fares, but also includes bus, train and air fares) dropped 3.1% in month-on-month (m/m) terms in January 2022, leaving the y/y rate at 10% (see chart 1).

Meanwhile, private transport (predominantly fuel prices) costs decreased by 2.1% m/m in January 2022 owing to a 68c/l drop in the price of petrol (95 inland). Private transport inflation averaged 16.2% in 2021, while public transport inflation averaged at a lower 5.3% in the same period.

According to the Central Energy Fund, the price of petrol (95 inland) rose by 53c/l in February and is expected to increase by 124c/l in March on the back of a recent surge in oil prices reflecting a risk premium related to attacks on fuel storage facilities in the United

Arab Emirates, related conflict in Yemen and rising fears of a Russian invasion of Ukraine.

Chart 1: Transport inflation (% y/y)

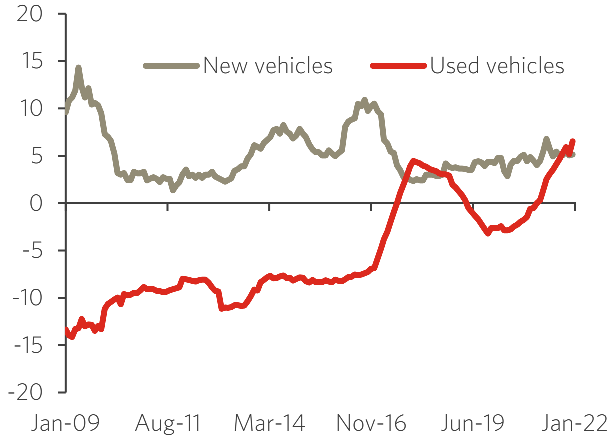


Source: Stats SA, Global Insight, Momentum Investments

Recent developments in the oil market suggest the peak in oil prices could be higher. Nevertheless, Capital Economics notes that Russian oil supply is unlikely to be affected and as such the current strife is not expected to have a structural effect on oil prices. As such, the current episode is viewed as a temporary shock and oil prices are expected to decline after a few months.

Nevertheless, higher transport costs could still filter through into raised local food prices, which account for 15.3% (previously 14.3%) of the inflation basket. Elsewhere in the transport category, new vehicle prices rose by 5.1% y/y in January 2022, while inflation in used vehicles increased by 6.5%. This is the highest recorded level of inflation in used vehicles since comparable data began in January 2009 (see chart 2).

Chart 2: New and used vehicle inflation (% y/y)



Source: Stats SA, Global Insight, Momentum Investments

Final summer crop harvest revised higher

The National Crop Estimates Committee revealed its revised total production figures, which show less flood damage than initially feared. The size of the commercial maize crop was calculated at 16.3 million tonnes, which is 0.5% higher than estimated in November 2021 and the second-largest harvest in the country's history. The recalculated white maize crop was 0.1% smaller, while the revised yellow maize crop was 1.2% higher (see table 2).

Final crop vs. November 2021 estimates (%)	
White maize	-0.1
Yellow maize	1.2
Sunflower seed	0.1
Soybeans	0.4
Groundnuts	7.3
Sorghum	0.6

Source: National Crop Estimates Committee

The upward revision in the final soybean crop marks it as the largest in history. The groundnuts crop is the largest in five years, while the sorghum crop is the largest in eight years, due to higher yields and an expansion in the planting area.

The Agricultural Business Chamber (Agbiz) notes that while in previous seasons a large harvest would exert downward pressure on local food prices, global events taking place in 2020/21 added upward pressure to prices. In particular, Agbiz flagged a poor harvest in South America and Thailand and rising demand in India and China, which placed upward pressure on global grains and oilseed prices.

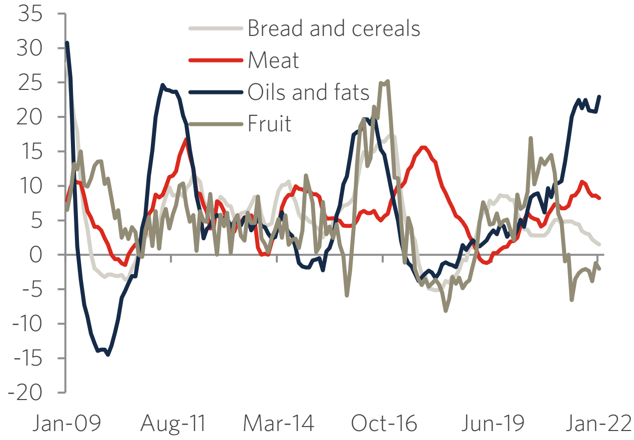
Agbiz flagged the dryness in South America as a risk for maize and soybean harvests in 2021/22. Global wheat usage has further increased, while Russian wheat supply through the Black Sea is likely to come under pressure.

The Global Food Price Index measured by the United Nations Food and Agricultural Organisation (UN FAO) remained elevated in January 2022, led by gains in vegetable oils and dairy prices. International cereal and meat indices were largely unchanged, while sugar prices declined.

Local food prices increased by 1% m/m in January 2022, led higher by a 1.2% m/m increase in meat prices, a 2.9% rise in the prices of oils and fats and a 3.4% m/m jump in vegetable prices. In y/y terms, inflation is highest for oils and fats (22.9%) and lowest for fruit (negative 2%), see chart 3.

According to Professor Johann Willemse (Agricultural Economist at the University of the Free State), food inflation could move sideways in 2022 relative to 2021 in the absence of any shocks. He raised higher production costs (transport, fertiliser and electricity) as a major risk to food producers. With domestic demand remaining weak, he expects a lid on meat inflation but further pressure on margins for producers in the protein market.

Chart 3: Local food inflation (% y/y)



Source: Global Insight, Momentum Investments

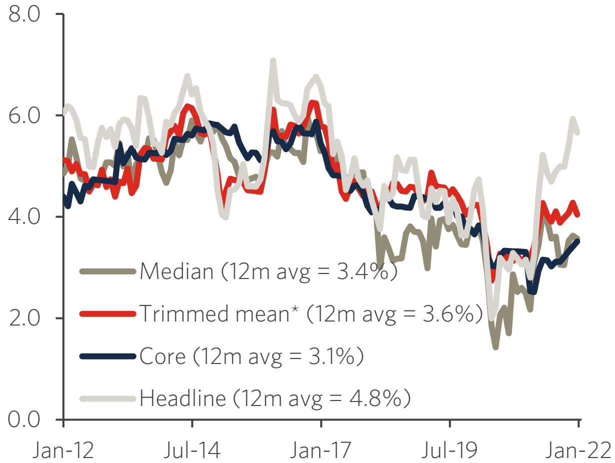
Unchanged view on the direction and magnitude of monetary policy moves from here

The January 2022 inflation figure does not derail our view on monetary policy moves for the remainder of the year. Moreover, the reweighting exercise undertaken by Stats SA has not materially changed our inflation forecasts. We expect headline inflation to average 4.9% in 2022, 4.3% in 2023 and 4.3% in 2024. On core inflation, we project an average of 3.6% for 2022, 3.9% in 2023 and 4.1% in 2024.

We continue to view international oil prices (due to rising geopolitical concerns), local electricity tariffs and worker wages as the main upside risks to the inflation trajectory. Nonetheless, underlying measures of inflation, including the trimmed mean and core inflation, remain considerably lower than the headline measure of inflation, indicating weaker underlying inflation pressures in the economy (see chart 4) and highlighting the effect of commodity price pressures on the headline measure. This is further reflected in the large gap between goods inflation (8.1% y/y) and services inflation (3.4% y/y) in January 2022, the latter which has a higher correlation with inflation expectations.

This leaves us comfortable with our assumption of a further three hikes in the SA repo rate of 25 basis points each for 2022, with the repo rate reaching a terminal value of 5.75% in early 2024.

Chart 4: Contained underlying inflation (% y/y)



Source: Stats SA, Global Insight, Momentum Investments