momentum
investments

in the moment

Herman van Papendorp
Head of Investment Research & Asset Allocation

Sanisha Packirisamy
Economist

Higher fuel prices behind March's rise in inflation

Highlights

- Headline inflation inched higher to 5.9% in March 2022 from 5.7% in February 2022. The figure came in slightly below the Reuters consensus estimate of 6% but met the Bloomberg consensus forecast of 5.9%.
- The monthly 1% rise in headline inflation was predominantly underpinned by an increase in fuel prices.
- Russia's further invasion of Ukraine drove international oil prices higher in April 2022. The monthly Oil Market Report for April 2022 by the Organisation for the Petroleum Exporting Countries (OPEC) shows a downward adjustment in global oil demand for the year amid severe new lockdown measures in China. The release of emergency reserves also aided a tight oil market. Nonetheless, the Organisation for Economic Co-operation and Development (OECD) countries insisted that no supply shortages exist, and they have agreed to a modest monthly output increment for May 2022.
- Higher fuel and fertiliser costs pose a threat to local food inflation in the coming months at a retail level. Although the recent flooding in KwaZulu-Natal has raised concerns over food security, agricultural experts suggest this can be avoided if government finds alternative routes to the port of Durban.
- Although the gap with goods inflation remained sizeable at 5.3%, services inflation ticked higher to 3.4% on the back of rising housing costs. Measures of underlying inflation, including core inflation, the median rate of inflation and the trimmed mean remain well within the 3% to 6% inflation target band but edged higher in March 2022.
- Higher international oil prices and an accelerated hiking cycle globally are likely to support a further normalisation in local interest rates to curb a further rise in inflation expectations. We continue to expect an interest rate increase of 25 basis points at the May 2022 interest rate setting meeting.

Headline inflation for March broadly in line with expectations

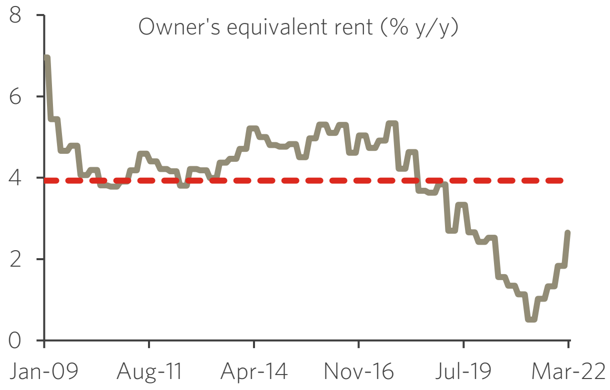
Statistics South Africa (Stats SA) reported an increase in headline inflation from 5.7% in February to 5.9% in March 2022. This figure was marginally lower than the Bloomberg median consensus figure of 6% but in line with the Reuters median consensus prediction of 5.9%.

March is typically a high survey month, with an additional 40% of the basket surveyed aside from the typical monthly surveys. Public transport fares, housing costs, education costs and vehicle insurance are surveyed in March.

The monthly 1% rise in headline inflation was primarily driven by the increase in fuel prices. Relative to our forecasts, price increases in alcoholic beverages, hotels and public transport surprised to the upside, while increases in vehicle prices and education fees surprised to the downside.

Owner's equivalent rent (which constitutes 13% of the consumer basket) rose by 2.7% year on year (y/y). This component of inflation has tracked below the lower band of the inflation target range of 3% to 6% for 31 consecutive months (see chart 1).

Chart 1: Rental inflation picking up from a low base

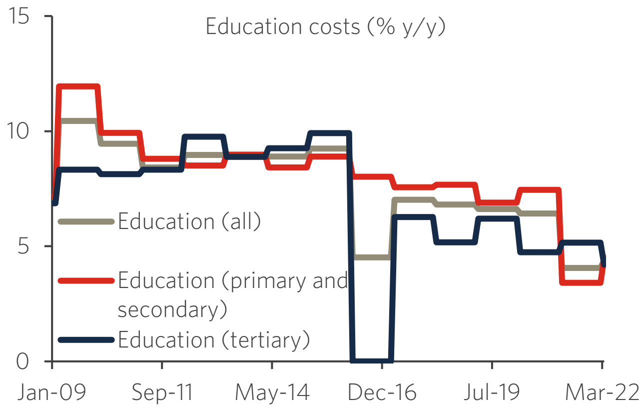


Source: Stats SA, Global Insight, Momentum Investments

Public transport fares jumped 3.5% in March 2022 relative to a month before, leaving y/y inflation at 14%, a level last seen in early 2013.

Education costs increased by 4.4% (relative to an historic average of 7.7%), see chart 2. Primary and secondary school fees increased at 4.5% y/y during the same period (relative to a longer-term average of 8.2%), while tertiary education costs escalated at 4.2% y/y (compared with a longer-term average of 6.9%).

Chart 2: Education inflation lower than long-term average



Source: Stats SA, Global Insight, Momentum Investments

International oil prices a key threat to headline inflation

Russia's further invasion of Ukraine in April 2022 drove international oil prices higher. The monthly Oil Market Report for April 2022 by OPEC shows a downward adjustment in global oil demand for the year amid severe new lockdown measures in China. Weaker-than-expected demand in the OECD countries at the start of this year has also added to the decline in global oil demand assumptions.

In addition, the release of strategic petroleum reserves in the United States has also aided a tight oil market. Nonetheless, the OPEC plus (OPEC+) countries insisted that no supply shortage existed and have agreed to a modest monthly output increment for May 2022.

The International Energy Agency warns that although Brent oil prices are back to pre-invasion levels, prices remain 'troublingly high and are a serious threat for the global economic outlook'. The latest World Economic Outlook report by the International Monetary Fund forecasts international oil prices at an average of US$107/bbl for 2022 and US$93/bbl for 2023, which are in line with the futures market.

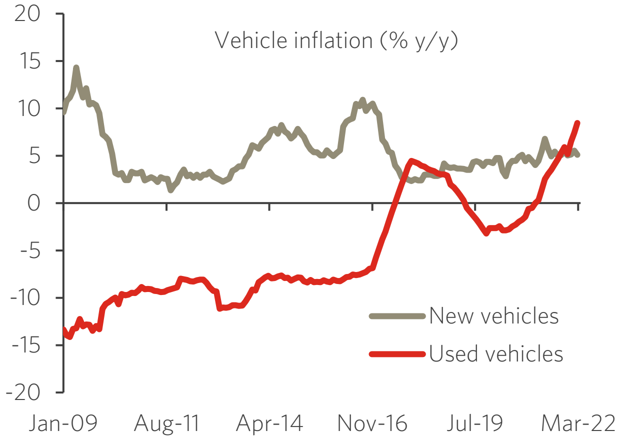
Transport inflation rose to 15.7% y/y in March 2022. Private transport (predominantly fuel prices) costs increased by 5.9% m/m owing to a 146/l increase in the price of petrol (95 inland).

According to the Central Energy Fund, the price of petrol (95 inland) rose by 36c/l in April. The SA government intervened to cushion the blow from what would have been a record-high petrol price increase in April 2022. Government temporarily reduced the general fuel levy by R1.50c/l for April and May.

This move is expected to be fiscally neutral given government's decision to sell part of the country's strategic fuel stocks. Data from the Central Energy Fund points to a current under-recovery of 35c/l for May 2022.

Elsewhere in the transport category, new vehicle prices rose by 5.1% y/y in March 2022, while inflation in used vehicles increased by 8.5% (see chart 3). This is the highest recorded level of inflation in used vehicles since comparable data began in January 2009.

Chart 3: Used vehicle inflation is tracking higher than new vehicle inflation

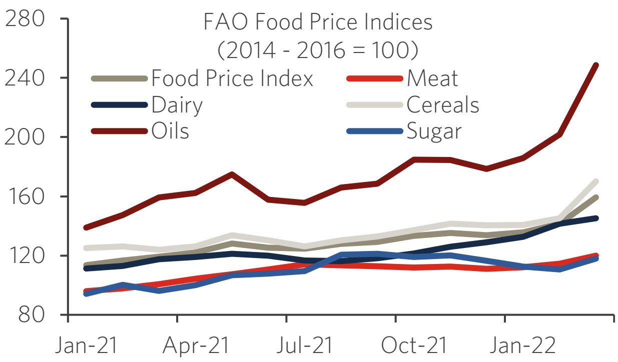


Source: Stats SA, Global Insight, Momentum Investments

Food inflation to reflect the effect of the Russia-Ukraine war in the coming months

The Global Food Price Index measured by the United Nations Food and Agricultural Organisation (UN FAO) ratcheted higher to a new all-time record in March 2022 (see chart 4), led by gains in vegetable oils, cereal and meat prices. Prices of sugar and dairy products also rose significantly in the month.

Chart 4: Further rise in global food inflation



Source: UN FAO, Momentum Investments
Data up to March 2022

Local food prices increased by 0.7% m/m in March 2022, led higher by a 1.1% m/m increase in bread and cereals prices, a 0.7% rise in the prices of meat and a 1.7% jump in sugar and dessert prices. In y/y terms, inflation is highest for oils and fats (19.8%) and lowest for fruit (negative 0.7%).

The Agricultural Business Chamber (Agbiz) predicts that the Russia-Ukraine war will have the largest effect on the bread/cereals and oils/fats components of the SA food inflation basket. Agbiz notes that while there is no major risk to supply in the local market, price increases are possible due to global events affecting grain and vegetable oil markets.

SA's third-largest sunflower seed harvest on record for the 2021/22 season is expected to boost local supplies and should reduce the country's reliance on imports. Agbiz also confirmed that a large share of the expected wheat imports has already taken place and importers have confirmed they would be able to secure the required amount for local consumption for the remainder of the year.

Agbiz added that the rise in geopolitical conflict could have a dampening effect on local fruit prices given the temporary limits of key exports in the Black Sea region. Moreover, local red meat prices may face downward pressure in the near term as an outbreak of foot-and-mouth disease could limit SA's exports of red meat, increasing local supplies relative to demand.

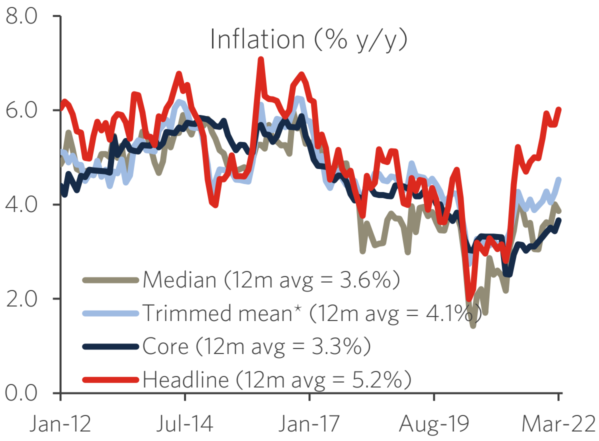
Higher transportation costs, in our view, continue to pose upside risks to local food costs, given the reliance on road transport. Agbiz notes winter crops (wheat, barley, canola and oats) will be predominantly affected in the coming weeks, while summer crops (including maize) will be less affected.

Although flooding in the province of KwaZulu-Natal raised concerns over food security, *Agricultural Economist Today* notes that government can avoid these risks if alternative routes to the port of Durban are found. Other provinces (including the Free State, Gauteng, Mpumalanga, North West and Limpopo) are more critical for agricultural production and food processing in SA but the port of Durban in KwaZulu-Natal is an important entry point for imported agricultural products such as rice, palm oil and wheat.

Frontloaded monetary policy normalisation likely to continue

Higher rental prices lifted services inflation to 3.4% but the gap with goods inflation remained wide at 5.3%. Underlying measures of inflation, including the trimmed mean and core inflation, remain considerably lower than the headline measure (see chart 5) but are edging higher. Given the positive relationship with core inflation, inflation expectations could have further upside in the coming quarters.

Chart 5: Underlying measures of inflation edging up



Source: Citi, Haver, Momentum Investments

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. In our view, the risk of sustained higher international oil prices and an accelerated hiking cycle globally could bring forward the local interest rate cycle to stem the rise in inflation expectations.

While we expect interest rate increments of 25 basis points to persist, any significant lurch higher in inflation expectations could prompt the SA Reserve Bank (SARB) to hike interest rates in larger increments of 50 basis points each to anchor inflation expectations closer to the midpoint of the inflation target range. We see the SARB hiking interest rates three times more this year (by 25 basis points each) and an additional three times next year (by 25 basis points each), leaving the terminal interest rate at 5.75%.