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Low base and higher fuel prices cause hefty increase in consumer price inflation

Highlights

- April's year-on-year (y/y) headline consumer price inflation (CPI) rate increased to 4,4% from 3,2% in March.
- Month-on-month (m/m) CPI rose by 0,7% in April, the same as in March and February.
- April's y/y headline CPI was heavily influenced by a low base and increases in fuel, food and new vehicle prices.
- A low base caused underlying CPI to trend upward as reflected by the 3% y/y increase in core CPI (2,5% in March) and 3,9% y/y increase in the Trimmed Mean Index (3,5% in March).
- Headline CPI is expected to breach the 4,5% mark targeted by the Monetary Policy Committee (MPC) in May.
- However, our view is still for the repo rate to remain unchanged this year.

CPI affected by a low base and high fuel prices in April

Headline CPI increased from 3,2% y/y in March to 4,4% y/y in April. On a m/m basis CPI increased by 0,7% compared to 0,7% in March. Underlying CPI is trending upward. The core CPI rate increased to 3% y/y from 2,5% y/y in March, while the trimmed mean index increased to 3,9% y/y from 3,5% y/y in March.

April's CPI was heavily affected by the low base established in the second quarter of 2020. The low base was caused by a sharp decline in commodity prices such as that of oil (due to the implementation of an 'international lockdown' in April last year), as well as Stats SA not being able to survey a number of prices in April 2020 resulting from the domestic lockdown.

Table 1 shows the y/y increases in the prices of goods and services that is likely to affect CPI most this year. A notable increase was fuel prices which increased by 21,4% (from 2,3% in March) on the back of the recovery in international oil prices from a low base.

Table 1: Percentage change in CPI (y/y)

	Apr-20	Mar-21	Apr-21
Bread & Cereals	3.7	4.9	4.9
Meat	6.1	6.7	7.1
Oils & Fats	6.5	13.4	16.7
Alcohol & tobacco	2.3	3.7	4.8
Housing (Rent & OER)	2.6	0.5	0.5
Water	7.2	5.9	5.9
Electricity	11.4	6.0	6.4
Domestic workers	4.6	2.1	2.1
New vehicles	3.4	4.4	5.5
Fuel	-12.8	2.3	21.4
Primary school fees	7.3	2.5	2.5
Secondary school fees	7.6	4.3	4.3
Tertiary tuition fees	4.7	5.1	5.1
Medical insurance	9.5	4.7	4.6
Headline CPI	3.0	3.2	4.4

Source: Stats SA, Momentum Investments

Fuel prices may drive headline CPI to 5% in May 2021, but underlying inflation should remain lower

Headline CPI for April 2021 was dominated by the sharp increase in fuel price inflation and will in all likelihood also dominate headline CPI in May 2021.

The y/y fuel price inflation rate increased from 2,3% in March 2021 to 21,4% in April 2021. This means that 22,1% (1,1 percentage points) of the increase in the y/y headline CPI rate was caused by higher fuel prices (see table 2).

Table 2: Contributions of selected items to y/y CPI (percentage points) in 2021

	Feb	Mar	Apr
Bread & Cereals	0.10	0.11	0.11
Meat	0.37	0.37	0.39
Oils & Fats	0.05	0.06	0.08
Alcohol & tobacco	0.23	0.21	0.28
Housing	0.19	0.08	0.08
Water	0.19	0.19	0.19
Electricity	0.23	0.23	0.24
Domestic workers	0.08	0.05	0.05
New vehicles	0.22	0.25	0.31
Fuel	-0.15	0.11	0.98
Primary school fees	0.06	0.02	0.02
Secondary school fees	0.06	0.03	0.03
Tertiary tuition fees	0.05	0.05	0.05
Crèche fees	0.02	0.01	0.01
Car & home insurance	0.03	0.03	0.03
Medical insurance	0.35	0.35	0.35
Other	0.79	1.05	1.24
Total	2.86	3.20	4.43

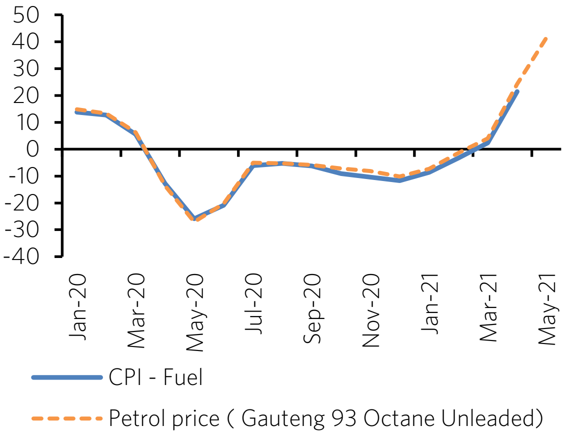
Source: Stats SA, Momentum Investments

The strong contribution of fuel prices to CPI can be traced back to mainly a sharp decline in international oil prices between January and May last year contributing to lower CPI in 2020, and a subsequent strong increase causing higher CPI right now. In April and May 2020 South Africa's fuel prices decreased sharply on the back of 'lockdown driven' declines in international oil prices. The global Brent crude oil price declined by 63,4% from US$63,6 per barrel in January 2020 to US$23,3 per barrel in April 2020. This contributed to the price of (93 octane unleaded) petrol in Gauteng declining by 13,1% from R15,84/l in January 2020 to R13,76/l in April 2020. A larger decline was prevented by a weaker rand – it depreciated from R14,41 against the US$ in January 2020 to R18,57in April 2020 – and a fuel levy of 25c/l instituted in the February 2020-21 budget.

However, the global Brent crude oil price recovered and increased by 178.1% from April 2020 (US$22,3 per barrel) to US$64.8 per barrel in April 2021. In addition, the fuel levy was increased by 27c/l in the February 2021-22 budget. Collectively, this contributed to the price of petrol in Gauteng being 24,7% higher at R17,10/l in April 2021 compared to a year before. Had it not been for the rand strengthening to R14,41 against the US$ in April 2021, the increase in the petrol price, and in headline CPI, would have been higher.

Fuel price inflation is bound to effect headline CPI for May 2021 even more. The price of petrol in Gauteng decreased further from R13,76/l in April 2020 to R12.02/l in May 2020, establishing an even lower base. However, it increased by 41,5% from the R12,02/l in May 2020 to R17,01/l in May 2021 (see chart 1). Such an increase can contribute 1,9 percentage points to headline CPI in May 2021. If fuel price inflation follows the same trend as that of the price of 93 octane unleaded petrol in Gauteng, headline CPI for May 2021 can increase to beyond 5%.

Chart 1: Fuel price inflation follows the trend of the change in the petrol price in Gauteng y/y (%)



Source: Stats SA, Momentum Investments

Apart from fuel prices, headline CPI continues to experience upward pressure from rising food price inflation. The prices of bread and cereals, meat and of oils and fats, which collectively carries a weighting of 53% in the food price index, persisted with increases above the MPC's target of 4,5%. The prices of bread and cereals increased by 4,9% y/y, meat by 7,1% y/y and oils and fats by 16,7 % y/y. Collectively they were responsible for almost 13% of the y/y increase in April's headline CPI. High international food prices stemming from increasing demand and supply shortages, especially in vegetable oils, as well as domestic issues such as a recovering cattle stock are responsible for the increases. The shortage of palm oils and seeds, which are used in the manufacture of vegetable oils, is affecting almost 50% of goods that are purchased in supermarkets, ranging from chocolates to household cleaning products.

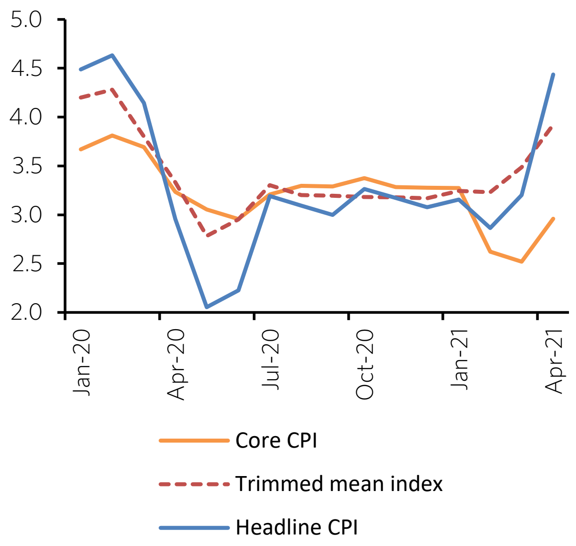
However, notwithstanding still strong y/y increases in international food prices, demand and supply dynamics differ between the international and domestic food markets. For instance, a strong domestic harvest and higher regional food harvests should reduce external demand. As such, the upward pressure from international food prices on domestic food prices should subside in the second half of 2021.

In addition, new vehicle inflation increased by 5,5% in April compared to a year ago (4,4% in March). As m/m inflation was lower in April compared to March, the increasing y/y inflation can to a large degree be ascribed to the low base established last year.

The trend in underlying consumer price inflation as reflected in core CPI and the trimmed mean index is upward, mostly on account of the low base. Core CPI, which excludes food, fuel and electricity prices, increased by 3% y/y. It increased by 0,3% m/m in April, less than the 0,5% in March. This shows little evidence of second round inflation, thus far (see chart 2).

The trimmed mean index (TMI), an index designed to remove volatility by excluding the highest 5% and the lowest 5% inflation rates from the headline CPI, started to drift upward in February 2021 and maintained this trend in March and April 2021. The TMI was up 3,9% in April y/y compared to 3,5% y/y in March (refer to chart 2), while the m/m change was 0,4%, the same as in March.

Chart 2: Underlying CPI as reflected by core CPI and the TMI y/y (%)



Source: Stats SA, Momentum Investments

Headline CPI should, however, reach its peak in the second quarter of 2021, and drift lower in the second half of 2021, mostly on account of smaller base effects and more stable international oil prices. This will to a large degree neutralise the increasing pressure on headline CPI expected from higher municipal rates.

Although headline CPI will breach the MPC's preferred target of 4,5% in the second quarter of 2021, the MPC is forward looking and is more concerned with the second-round effects of increases in fuel and electricity prices. The MPC will therefore monitor core CPI closely for signs of strong second round inflation.

At this stage, estimates show that headline CPI may remain close to the MPC's preferred target of 4,5% in the next two years. We therefore don't expect an increase in the repo rate this year.