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# in the moment


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## Moderation in base effects drives inflation down to 4.6% in July

### Highlights

- Headline inflation moderated to 4.6% in July 2021 from 4.9% in June, which was in line with the Reuters consensus forecast. Easing base effects in petrol prices and steady food inflation helped offset higher inflation in the housing and utilities category.
- The monthly increase of 1.1% in the headline figure was primarily driven by utility (water and electricity) costs.
- Core inflation dipped from 3.2% to 3% for the same period, reflecting subdued domestic demand.
- A tightening in lockdown regulations, which resulted in the banning of alcoholic beverages for the first three weeks in July, affected the collection of prices in this category.
- Statistics South Africa (Stats SA) noted, due to budget constraints, the Income and Expenditure survey could not be conducted. While this survey is traditionally used to update the weights of the components in the inflation basket, Stats SA will instead use national accounts data, supplemented by additional surveys conducted by Stats SA, to calculate the new set of weights which will be applied from January 2022.
- In our view, benign inflation and longer-dated inflation expectations, which remain close to the midpoint of the target band could allow the SA Reserve Bank (SARB) to hold off from raising interest rates until the first quarter of 2022.

### Headline and core inflation moderated in July

Headline inflation dropped from 4.9% in June 2021 to 4.6% in July 2021, meeting the Reuters consensus expectation. Although water and electricity costs were surveyed in July, easing base effects in fuel prices and steady food inflation helped offset the increase in utility prices.

In month-on-month (m/m) terms, inflation edged up by 1.1% (higher than the previous month's increase of 0.2%), driven by a 4% m/m increase in water tariffs and a 13.6% m/m increase in electricity costs.
The increase in water tariffs surprised to the downside given the average 7.8% increase observed over the past 13 years, for which comparable data is available (see table 1).

Underlying or core inflation (which excludes the effect of food, fuel, non-alcoholic beverages and energy) declined to the bottom end of the inflation target range at 3% in July from 3.2% in June. In m/m terms, core inflation rose 0.5%. Part of this increase arose from higher medical aid insurance, which surprised marginally to the upside at 5.9% (see chart 1).

Services inflation, which accounts for roughly half of the consumer basket, fell further from 2.9% to 2.7%.

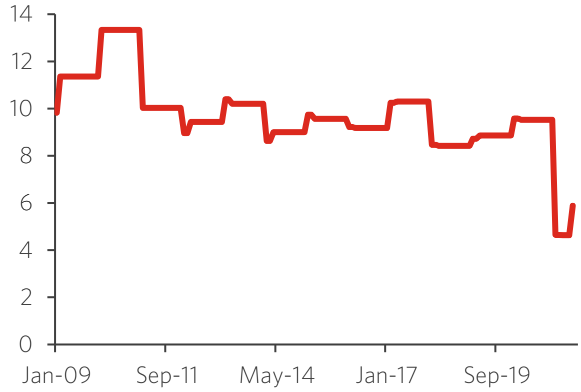
Inflation in this category has averaged 3.3% in the last 12 months, which is significantly lower than the long-term average of 5.7% since 2009.

Table 1: Historical water tariff increases in July (% m/m)

| | |
|---|---|
| 2008 | 4.4 |
| 2009 | 8.7 |
| 2010 | 8.7 |
| 2011 | 8.8 |
| 2012 | 8.5 |
| 2013 | 7.9 |
| 2014 | 8.4 |
| 2015 | 9.7 |
| 2016 | 8.1 |
| 2017 | 6.4 |
| 2018 | 10.2 |
| 2019 | 6.4 |
| 2020 | 5.2 |

*Source: Global Insight, Momentum Investments*

Chart 1: Medical aid insurance (% y/y)




*Source: Stats SA, Momentum Investments, latest data for July 2021*

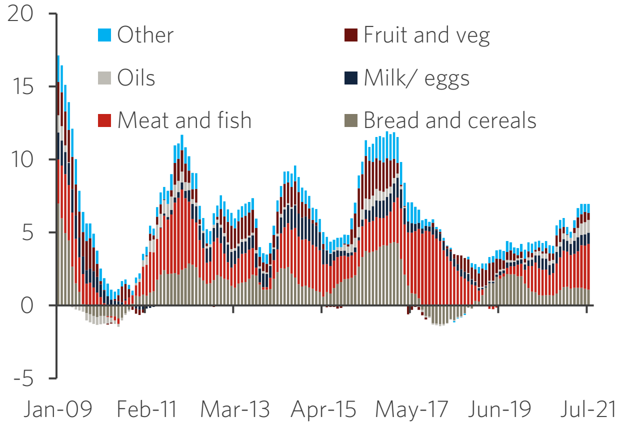
## Another good production season forecasted which should keep a lid on food inflation

After rising for five consecutive months, food inflation stabilised at 7% in year-on-year (y/y) terms in July 2021. Meat and fish prices contributed towards 45% of the y/y increase in food prices, while bread and cereal prices accounted for less than 20% (see chart 2).

According to the Agricultural Business Chamber (Agbiz), despite less abundant rainfall relative to the 2020/21 season, tractor sales, the weather outlook for the next five months (above normal rainfall during the early part of summer) and grains and oilseed prices are suggestive of a favourable production season which starts in October 2021. This, together with the recent decline in international food prices (after a year of consecutive increases), should keep food inflation contained in the near term.

Agbiz has further noted that a bumper 2020/21 season should allow agricultural exports to beat those of the previous year even after taking into account the July 2021 unrest, when IT problems resulted in delays in export activity.

Chart 2: Contribution to food inflation (% y/y)




*Source: Global Insight, Momentum Investments*

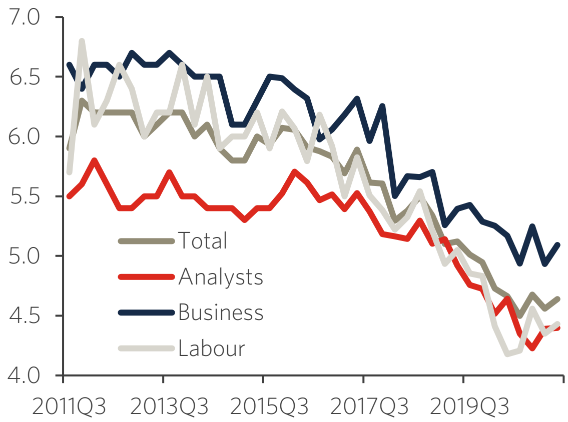
## No pressure to raise interest rates soon

In our opinion, subdued inflation and well-behaved longer term inflation expectations (surveyed quarterly by the Bureau of Economic Research (BER)) suggest little pressure on the SARB to raise interest rates soon and as such we project steady interest rates until the first quarter of 2022.

The latest Reuters Econometer for July 2021 points to a consensus expectation for headline inflation of 4.3% on average in 2021 and 4.4% in 2022 and 2023, which falls below the midpoint of the target band. In the BER Inflation Expectations Survey for the second quarter of 2021, analysts and labour respondents kept their average five-year ahead inflation expectations steady at 4.4%, while expectations from businesses inched higher from 4.9% to 5.1% (see chart 3).

From 23 analysts surveyed in the Reuters Econometer poll for July 2021, four are expecting interest rate increases from the SARB before year end, while another 10 expect interest rates to rise before the end of the first quarter of 2022.

Chart 3: Average five-year ahead inflation expectations (% y/y)




*Source: BER, Momentum Investments, data up to Q2 2021*