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CPI subsided in June, but effects of riots unknown

Highlights

- June's year-on-year (y/y) headline consumer price inflation (CPI) rate decreased to 4.9% from 5.2% in May.
- Month-on-month (m/m) headline CPI rose by a still subdued 0.2% in June compared to 0.1% in May.
- The lower y/y headline CPI rate in June was mostly caused by a smaller y/y increase in the price of fuel.
- Fuel, meat and rent contributed to upward pressure on headline CPI.
- Core CPI increased to 3.2% y/y from 3.1%.
- CPI for July and August will receive upward pressure from municipal rate increases and the effect of the riots.
- The destruction caused to supply chains and infrastructure by rioters may put upward pressure on CPI, but the magnitude thereof will only be known once specifics become available.
- The effect of the riots on CPI should not contribute to a faster increase in interest rates.

Headline CPI declined due to lower fuel price increases, rental CPI still low

South Africa's y/y headline CPI rate for June declined to 4.9% from 5.2% in May. The core CPI rate increased to 3.2% y/y from 3.1% in May. Last year's sharp decline in fuel prices, which contributed to establishing a low base in 2020, had a smaller effect on June's y/y CPI compared to May.

Stats SA among others surveyed price changes in housing rentals which increased by 1% y/y, up from 0.5%.

On a m/m basis, headline and core CPI increased by respectively 0.2% and 0.3% in June. Rental CPI of 0.6% m/m added pressure to core CPI.

Although it is difficult to, at this stage, quantify the effect of the riots on CPI, table 1 provides a summary of the y/y increases in the prices of items that affected and will affect CPI most this year.

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

	April-21	May-21	June-21
Bread & Cereals	4.9	4.9	4.6
Meat	7.1	8.5	8.6
Alcohol & tobacco	4.8	5.8	5.3
Housing rentals (Rent & OER*)	0.5	0.5	1.0
Water	5.9	5.9	5.9
Electricity	6.4	6.2	6.2
New vehicles	5.5	6.7	5.8
Used vehicles	1.4	2.5	3.1
Fuel	21.4	37.4	27.5
Primary school fees	11.6	0.7	2.4
Secondary school fees	-0.9	-1.9	-2.1
Tertiary tuition fees	5.1	5.1	5.1
Medical insurance	4.6	4.6	4.6
Headline CPI	4.4	5.2	4.9

**OER = Owners' equivalent rent*

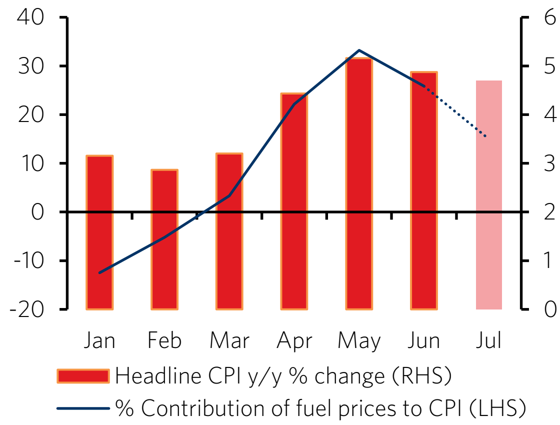
Source: Stats SA, Momentum Investments

Headline CPI trending down, but riots and municipal rates should limit the decline

As expected, headline CPI decreased to 4.9% y/y in June following the peak of 5.2% reached in May. Headline CPI is expected to remain above the inflation target of 4.5% in the rest of the year and most of next year. At this stage the headline CPI rate is expected to decline in the third quarter of 2021, remain at these levels in the fourth quarter, increase slightly in the first quarter of 2022, whereafter its trajectory is expected to decline towards the inflation target.

The largest part of near-term moderation in headline CPI should come from diminishing base effects and slower increases in international commodity prices, such as oil, which should reduce the pressure of fuel prices on headline CPI. The combined effect of a low base and higher oil prices had been a driving force of increasing headline CPI (see chart 1). It contributed more than 33% of the increase in May's headline CPI. Its contribution decreased to 26% of June's CPI and is projected to decline to around 15% of July's CPI.

Chart 1: Contribution of fuel prices to headline CPI subsiding

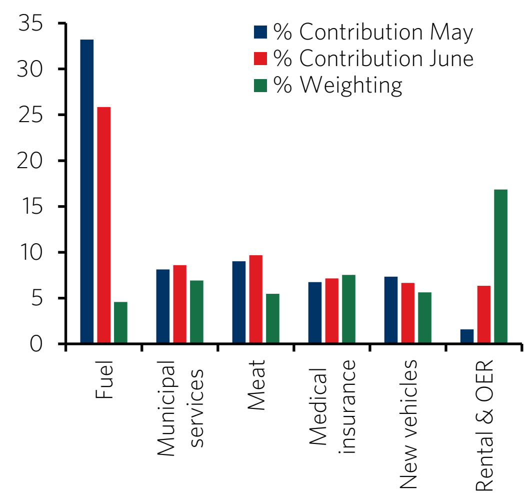


Source: Stats SA, Momentum Investments

Whereas the contribution of fuel prices on headline CPI should diminish, some food prices continue to add pressure to CPI. Fortunately, though, the pressure on domestic food prices from international food prices abated somewhat in June. The International Food Price Index (FPI), as calculated by the Food and Agriculture Organisation of the United Nations, declined in June from May, mostly on account of increasing supply of grains, as well as palm-, soy- and sunflower oils. This is the first decline in twelve months and if this trend continues, food prices are due to add less pressure on headline CPI in the second half of 2021. Food CPI increased by 7% y/y in June from 6.8% y/y in May, while the m/m increase of 0.2% was somewhat lower than May's 0.7%. Vegetable oil prices continued to increase at an elevated rate of 21.6% y/y in June, but the steep increase should receive some reprieve from lower international prices. Meat prices increased by 8.6% y/y in June from 8.5% in May y/y due to supply shortages and increasing input costs.

Rentals CPI, which includes both rental of residential houses, flats and town houses, as well as owners' equivalent rent, carries a large weighting of 16.84% in the consumer price index. It increased by 1% y/y in June compared to 0.5% in the previous three months. Rental prices are receiving downward pressure from increasing vacancies. This was caused by the low interest rate, which swayed many households to purchase property rather than renting, as well as from a loss of income stemming from the effect of COVID-19 and lockdowns. The latter contributed to many households having to forego leases and moving in with family and friends. This situation is due to continue for some time and should limit rentals' contribution to CPI (see chart 2).

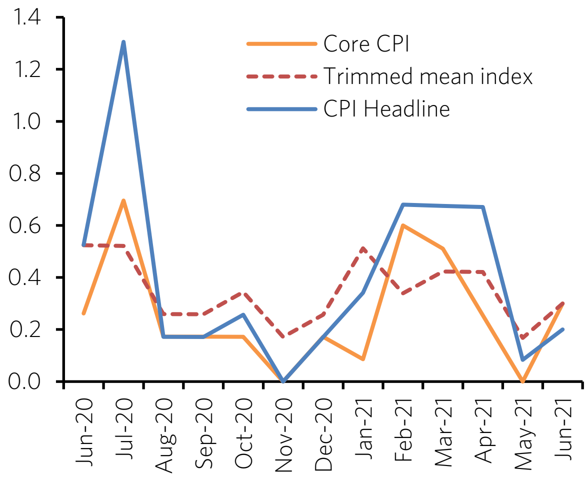
Chart 2: Contribution of some prominent items to headline CPI



Source: Stats SA, Momentum Investments

Analysing m/m CPI, which eliminates the effect of the low base, reveals that price pressures are still muted to moderate. Headline CPI increased by 0.2% on a m/m basis in June, following a 0.1% m/m increase in May. Although core CPI increased 3.2% on a y/y basis, the m/m increase was still moderate at 0.3%. The trimmed mean index, which excludes the top and bottom 5% price increases, also increased 0.3% following a 0.2% increase in May (see chart 3). The m/m increase of 0.6% in rental CPI contributed to these monthly increases.

Chart 3: Headline, core and trimmed mean m/m CPI still moderate



Source: Stats SA, Momentum Investments

As for other items that may put upward pressure on headline and core CPI, Stats SA will survey municipal rate increases in July and August. Preliminary indications are that the hefty increases may add 0.2 percentage points to y/y headline CPI. However, the effects of the factors contributing to lower CPI in July should outweigh the effect of higher municipal rates, suggesting a lower y/y CPI in July.

The effect of the recent riots may find its way into CPI. The destruction of property and inventory is bound to affect supply chains, but it is difficult to quantify the effect on CPI. At this stage it seems as if food, clothing, household appliances and pharmaceuticals were most affected by the riots. Newspapers listed the following looted and plundered institutions: 90 pharmacies, 1 400 ATM's, 300 banks and post offices, a Cipla pharmaceutical factory, 12 Mr Price retail outlets, 99 Famous Brand outlets including Steers and Wimpy fast-food restaurants, 32 Cashbuild outlets, 190 Foschini and 489 Pepkor outlets (including Pep, Ackermans and JD Group), 33 Massmart shops including Game, Builders Warehouse and Makro, 212 Pick n Pay outlets and a South African National Blood Service centre. Refineries and delivery of fuel were also affected, contributing to a fuel scarcity in some areas.

The magnitude of the effect on CPI will to a large degree depend on how supply management and -recovery is handled. Companies already received the green light to co-operate outside the bounds of the Competition Act in an attempt to restore the availability of goods as soon as possible, as well as minimising the effect on the cost of supply. The government also requested SASRIA, the state insurer against among others, damages resulting from riots, to deal speedily with claims to allow for a quick recovery. The effect on CPI could therefore be limited, if handled well.

It is expected that the Monetary Policy Committee (MPC) of the South African Reserve Bank will, for now, disregard the effect of the riots on near-term CPI. The inflation targeting framework makes provision for disregarding the initial effect of 'once-off' events on CPI. Second round effects are, at this stage, not envisaged. As such, it is plausible that the MPC may, given the devastating effects of the riots on the economic recovery, consider less hawkishness for a while.