momentum
investments

Herman van Papendorp
Head of Investment Research & Asset Allocation

Sanisha Packirisamy
Economist

in the moment

Fuel prices drive headline inflation higher to 4.9% in August

Highlights

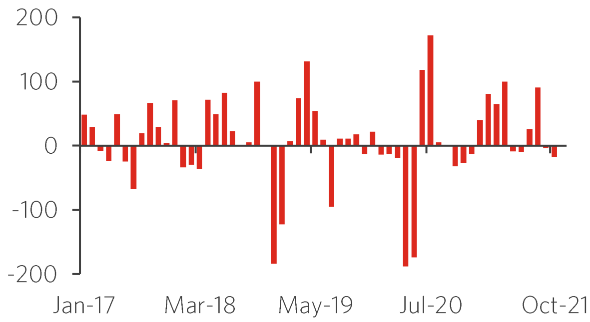
- Headline inflation lifted from 4.6% in July to 4.9% in August 2021 largely owing to fuel inflation, which rose to 19.6% year-on-year (y/y), after factoring in a 91c/l increase in 95 petrol (inland).
- The headline figure was broadly in line with the Reuters consensus forecast of 4.8% and had a limited effect on market moves.
- The monthly increase of 0.4% in the headline figure was primarily driven by transport costs.
- Core inflation nudged higher to 3.1% from 3% for the same period (broadly in line with the Reuters consensus), reflecting subdued domestic demand.
- Only three out of the 28 inflation categories experienced inflation in excess of 6% in August 2021.
- Higher food and fuel weightings in consumer inflation baskets in other emerging markets (EMs) have triggered higher rates of headline inflation and have prompted central banks, in these markets, to raise interest rates.
- In South Africa's (SA) case, services constitute around half of the inflation basket and lower price pressures in this component of the basket have provided an anchor for headline inflation.
- In our view, benign inflation and longer-dated inflation expectations (which remain close to the midpoint of the target band), together with a narrowing output gap, could allow the SA Reserve Bank (SARB) to stave off interest rate hikes until the first quarter of 2022.

Headline inflation shifted higher in August on higher fuel prices

Broadly in line with market expectations, headline inflation jumped to 4.9% in August 2021 from 4.6% in July 2021 on fuel costs which climbed 19.6% y/y. The price of 95 petrol (inland) increased by 91c/l in August 2021, while diesel costs rose by 56c/l.

In month-on-month (m/m) terms, inflation edged up by 0.4% (lower than the previous month's increase of 1.1%), buoyed by a 2.2% m/m increase in transport costs (predominantly fuel prices).

Chart 1: Petrol price change (95 Octane, c/l)



Source: Stats SA, Central Energy Fund, Momentum Investments

Petrol prices (95 inland) are expected to increase marginally by 4c/l in September 2021, while the current over-recovery in fuel prices points to a c.18c/l drop in October 2021 (see chart 1).

New vehicle prices declined by 0.4% y/y (new vehicle prices have been in deflation for the past 21 months), while inflation in used vehicles dropped from 4.9% y/y in July 2021 to 4.5% y/y in August 2021.

Underlying or core inflation (which excludes the effect of food, fuel, non-alcoholic beverages and energy) remained at the bottom end of the 3% to 6% inflation in August 2021. In m/m terms, core inflation rose 0.3%, which was broadly in line with the Reuters consensus.

August is usually a low surveyed month, with only 6% of the basket surveyed in addition to the normal monthly surveys. Residual water and electricity tariffs (the bulk are surveyed in July) and hospital fees are traditionally surveyed in August. Relative to our expectations, the prices of food, clothing and footwear and public transport surprised to the upside, while inflation in other services and personal care came in lower than anticipated.

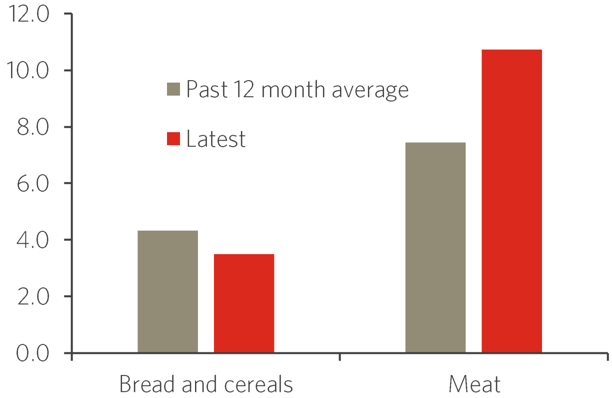
Global food prices surge again, but another good production season forecasted domestically

After a brief two-month reprieve, global food prices rebounded in August 2021. The FAO Index calibrated by the Food and Agricultural Organisation of the United Nations rose 3.1% m/m and 32.9% y/y owing to a sharp rise in sugar, oil and cereal prices.

In SA, healthy stocks, good soil conditions and favourable weather conditions are expected to keep a lid on local food inflation. The SA Weather Services predicts a higher than 50% chance of La Niña conditions between September 2021 and January 2022. The latest Agri Market Viewpoint by the Agricultural Business Chamber indicates that light showers are anticipated across most regions in the country toward the end of the month, boding well for the upcoming 2021/22 summer crop, as planting commences in October 2021. Tractor sales data, measured by the SA Agricultural Machinery Association, further corroborate this sentiment. On a year-to-date basis, tractor sales were 30% higher relative to the same period a year ago. The Agricultural Business Chamber however warns that rising input costs (fertilizer, herbicides and fuel) could add pressure to farmers' finances.

Food inflation rose to 7.4% in year-on-year (y/y) terms in August 2021. Meat (0.8% m/m, 10.7% y/y), fish (1.1% m/m, 6% y/y), fruit (0.7% m/m, negative 2.2% y/y) and vegetable prices (1.4% m/m, 5.6% y/y) contributed the most to the 0.4% monthly increase in food prices, while prices of bread and cereal dipped 0.5% m/m (3.5% y/y), see chart 2. The recent outbreak of foot-and-mouth disease in KwaZulu-Natal could push meat prices lower in SA as export bans increased meat supply in the domestic market. Meanwhile, the Agricultural Business Chamber notes an expected decline in domestic grain prices, based on the improvement in grain and oilseed production in North America and Europe. The Agricultural Business Chamber acknowledges local fundamentals and exchange rates as key factors determining the price of local grains but notes the increasing influence of global developments.

Chart 2: Food inflation (% y/y)



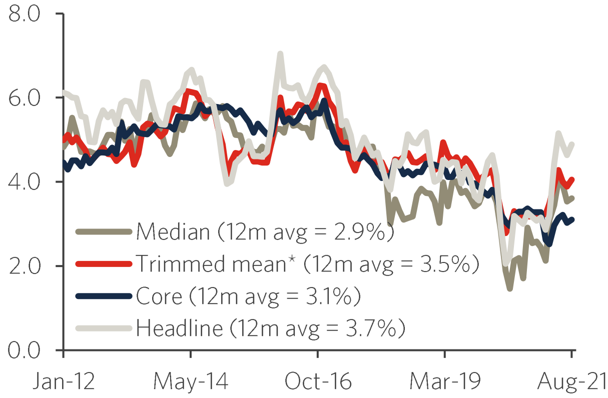
Source: Global Insight, Momentum Investments

Only three items in the inflation basket experienced inflation above 6%

On a disaggregated basis, inflation in nearly 40% of the weighted consumer inflation basket traded below 3%, while inflation in a fifth of the basket is higher than the upper end of the 3% to 6% target. There were only three out of 28 categories which experienced inflation above the top end of the target band in August 2021. This included food (weighting of 14.3%), electricity (weighting of 1.9%) and private transport (4.8%).

The median rate of inflation crept higher to 3.6% y/y, which is slightly above its past 12-month average, while the trimmed mean (excludes the top 5% and bottom 5% of inflation items) ticked higher to 4.1%. Chart 3 suggests inflation pressures are not broad-based in the SA context, similar to what is being observed elsewhere in key developed markets, where pandemic-related items experienced a surge in inflation, but items associated with a reopening of the economy have experienced much lower rates of inflation.

Chart 3: Measures of inflation (% y/y)

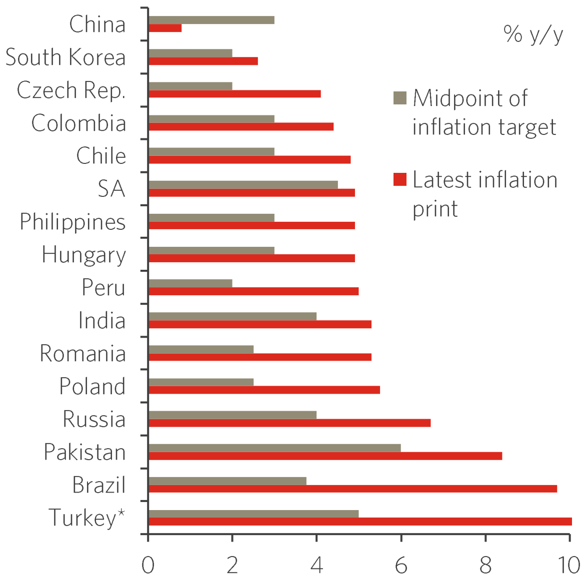


*Source: Global Insight, Momentum Investments, *excluding top and bottom 5%*

No imminent pressure to raise local interest rates

Unlike in many other EMs, inflation remains well within SA's 3% to 6% inflation target range. Since the start of the year, Russia, South Korea, Hungary, Mexico, Czech Republic, Brazil and Turkey have all increased interest rates, yet inflation remains significantly above the midpoints of the respective targets in a number of these countries (see chart 4).

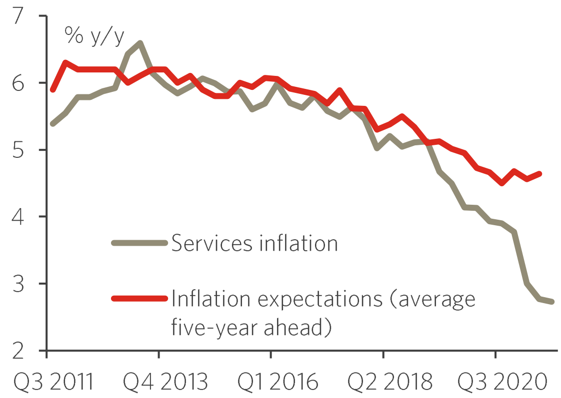
Chart 4: EM inflation pressure building



Source: Bloomberg, Momentum Investments, Turkey's latest inflation = 19.3%

The latest Reuters Econometer for September 2021 points to a median consensus expectation for headline SA inflation of 4.4% on average in 2021 and 2022 and 4.2% for 2023. Our forecasts are broadly in line for 2021 and 2022 at 4.4% and 4.3% but differ marginally for 2023 (4.5%).

Chart 5: Lower services inflation provides an anchor



Source: BER, Global Insights, Momentum Investments

In addition, 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. 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%. The longer-term slide in services inflation (inched up from 2.7% in July 2021 to 2.8% y/y in August 2021) bodes well for contained inflation expectations (see chart 5).

While services account for 35% of the consumer inflation basket in EMs on average, services constitute around half of the SA inflation basket. As such, declining services inflation aided a drop in SA's overall inflation, whereas higher food and fuel weightings in other EMs saw inflation pressures building faster at the headline level.

From 20 analysts surveyed in the Reuters Econometer poll for September 2021, none are expecting an interest rate hike in the third quarter of 2021 (from one previously in August 2021), while five anticipate a rate increase before the end of the year. In our view, benign inflation and longer-dated inflation expectations (which remain close to the midpoint of the target band), together with a narrowing output gap, could allow the SA Reserve Bank (SARB) to stave off interest rate hikes until the first quarter of 2022.