



## Inflation lower in February, but hefty increases in some items on the way

### Highlights

- February's year-on-year (y/y) headline inflation rate declined to 2,9% in February from 3,2% in January.
- Month-on-month (m/m) inflation rose by 0,7% in February compared to 0,3% in January.
- The main drivers behind February's monthly increase were the fuel and medical insurance categories, while meat, housing, water and electricity, new vehicles and medical insurance contributed most to the y/y increase.
- Core inflation subsided to 2,6% y/y (3,3% in January), while it increased 0,6% m/m compared to 0,1% in January.
- Core inflation will grow more important as an indicator to gauge the strength of second round inflation.
- The Monetary Policy Committee (MPC) of the South African Reserve Bank (Sarb) will likely keep the repo rate unchanged at its next meeting and throughout 2021.

### Upward momentum in CPI briefly halted in February

The headline consumer price inflation (CPI) rate decreased to 2,9% in February from 3,2% in January y/y. On a m/m basis CPI increased 0,7% compared to January's 0,3%.

The core inflation rate decreased to 2,6% from 3,3% in January, showing subdued inflationary pressures outside of food, electricity and fuel.

Table 1 shows the average y/y increases in the prices of goods and services that is likely to affect CPI this year, either in the immediate short-term, or in the second half of the year. The effect of some food, fuel and energy prices on CPI was, however, limited by medical insurance inflation which increased by only 4,7% y/y in February, about half the 9,6% y/y in February 2020.

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

	Feb-20	Jan-21	Feb-21
Bread & Cereals	4,8	5,1	4,6
Meat	4,1	7,2	5,7
Oils & Fats	5,1	10,5	10,6
Alcohol & tobacco	4,9	3,5	4,0
Housing (Rent & OER)	2,5	1,1	1,1
Water	7,3	6,0	5,9
Electricity	11,9	5,9	6,0
Domestic workers	4,4	3,4	3,4
New vehicles	4,7	4,5	4,0
Fuel	12,7	-8,6	-3,3
Education	6,7	6,4	6,4
Medical insurance	9,6	9,5	4,7
<b>Total</b>	<b>4,6</b>	<b>3,1</b>	<b>2,9</b>

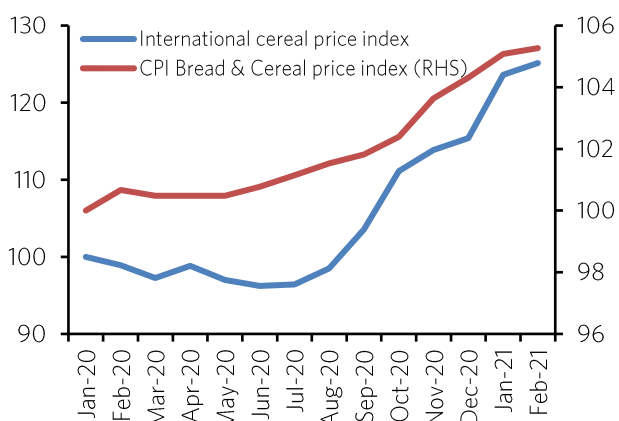
Source Stats SA, Momentum Investments

## An increase in CPI is expected to gain pace in the next few months before subsiding

CPI are experiencing constant upward momentum from some food prices and higher fuel prices, while higher excise duties on alcohol and tobacco (8% increase) drove CPI higher than what it could have been.

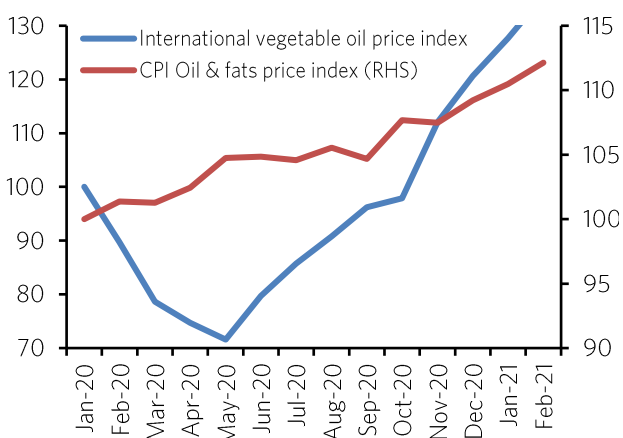
Food prices are encountering pressure from a number of sources. Internationally, it stems from China's rising demand for grain, while lower global palm oil supplies continue to drive vegetable oil prices higher (see figures 1 and 2). As grain is also used as inputs for animal feeds, it also puts upward pressure on meat prices. The rising trend in international prices should subside soon.

Figure 1: Rising international grain prices affect local prices



Source: Food and Agriculture Organisation of the UN, Stats SA, Momentum Investments

Figure 2: Rising international vegetable oil prices affect local prices



Source: Food and Agriculture Organisation of the UN, Stats SA, Momentum Investments

International oil prices also continued its upward trend due to higher demand. In US\$-terms, the Brent oil price was on average 13,3% higher in February compared to January. Fortunately, though, a relatively stronger local currency compared to January 2021 prevented an even higher pass-through to domestic food and fuel prices.

Alcohol and tobacco prices were partly affected by the excise duty of 8% that was levied on these products in the national budget.

As table 2 shows, fuel and medical insurance contributed strongly to the m/m percentage change, while meat, alcohol and tobacco, housing, water and electricity and medical insurance added most to the y/y percentage change in CPI.

Table 2: Contributions of selected items to m/m and y/y CPI (percentage points)

	m/m	y/y
Bread & Cereals	0.0	0.1
Meat	0.0	0.4
Oils & Fats	0.0	0.0
Alcohol & tobacco	0.0	0.2
Housing	0.0	0.2
Water	0.0	0.2
Electricity	0.0	0.2
Domestic workers	0.0	0.1
New vehicles	0.0	0.2
Fuel	0.2	-0.1
Education	0.0	0.2
Medical insurance	0.3	0.3
Other	0.1	0.8
<b>Total</b>	<b>0.7</b>	<b>2.9</b>

Source: Stats SA, Momentum Investments

A smaller increase in medical insurance inflation, however, contained the impact of price increases in other items in the CPI-basket. Medical schemes increased their contribution rates by an average of 4,7% in February 2021 compared to 9,6% a year ago. Given the large weight medical insurance has in the CPI-basket (7,52%), its m/m and y/y contributions to CPI was much smaller this time around. On a m/m and

y/y basis its contribution was 0,3 percentage points. A year ago, it was 0,7 percentage points on both a m/m and y/y basis.

March's CPI will in all likelihood receive pressure to increase from a few sources. A 22,6% increase in the minimum wage of domestic workers may add almost 0,6 percentage points to the CPI and higher fuel prices another 0,2 percentage points (at current oil prices). However, CPI will really accelerate from April onward on the back of a low base and higher food and fuel prices. Indications are that CPI can increase to higher than 5%, whereafter the increase may subside.

The MPC will likely emphasise that CPI is on an upward trend and will therefore probably use more hawkish language in its March statement to be delivered tomorrow. There might also be a change in the 3-2 split in MPC-member votes to 4-1 or 5-0, indicating that more MPC members may vote for no change in the repo rate rather than a decrease.

However, they will seriously consider that South Africa is still in the midst of a health pandemic with a bleak vaccination outlook, as well as high unemployment.

The MPC will likely also continue to follow the rules of the inflation targeting framework and look for evidence of second round effects accruing from higher food, fuel and electricity prices. Consequently, core inflation will grow in importance as an indicator to gauge MPC-decisions going forward.

It is expected that the MPC will keep the repo rate unchanged tomorrow. At this stage, no interest rate increases are expected this year.

Table 3: Expected price pressures on CPI during the first half of 2021

Weight	Item	Direction
2.6	Education & boarding	↓
7.5	Medical insurance	↓
15.5	Food	↑
1.8	Non-alcoholic beverages	↑
3.9	Alcoholic beverages	↑
1.9	Tobacco	↑
3.8	Clothing & footwear	↓
3.5	Actual rentals for housing	↓
13.3	Owners' equivalent rent	↓
3.2	Water & other services	↑
3.8	Electricity & other fuels	↑
4.4	Household contents	↔
5.6	New vehicles	↑
4.6	Fuel	↑
2.6	Communication	↓
5.2	Recreation & Culture	↔
3.1	Restaurants & hotels	↔
1.3	Other services (Funeral)	↑
<b>Overall CPI</b>		<b>↑</b>

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