



The Macro Research Desk

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Another positive inflation surprise for August 2018

Highlights

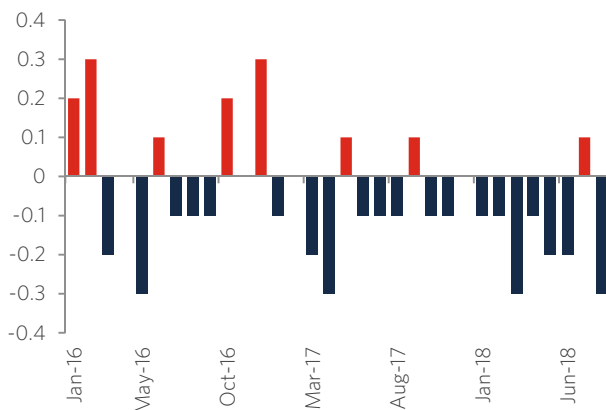
- Headline inflation positively surprised relative to consensus estimates for 70% of the time since January 2016.
- Half of the items in the consumer basket printed inflation rates below 3% in August 2018.
- Food inflation continued to track at non-threatening levels, surprising yet again to the downside.
- However, steep increases in rand oil prices (relative to a year ago) put further upward price pressure on the overall consumer basket, particularly for higher income earners.
- Mild food inflation continued to disproportionately benefit low-income earners in August 2018.
- Core and services inflation remained subdued, but pressure has arisen in administered prices.
- Interest rates are expected to remain on hold at the upcoming interest rate-setting meeting.

Half of the items in the consumer basket, on a weighted basis, printed below 3%

According to Statistics South Africa (Stats SA), consumer price inflation (CPI) surprised the market positively and came in 0.3% lower than the consensus expectation for a 5.2% rise in August 2018. Inflation remained relatively steady from a month earlier, decreasing by 0.1% in month-on-month (m/m) terms.

Actual inflation prints have surprised positively (lower than market expectations) in more than 70% of the monthly prints since the start of 2016. In Momentum Investments' view, lower services inflation, muted currency pass-through and subdued food inflation contributed to the trend in downward surprises in recent months.

Chart 1: Actual less surveyed CPI (%)



Source: Bloomberg, Momentum Investments, data up to August 2018

August is generally a low surveyed month. Only 6% of the basket was surveyed in addition to the regular surveys which are conducted monthly. Relative to Momentum Investments' forecasts, inflation in the food, vehicles and personal care categories reported the largest downside surprises, while inflation in health services and non-alcoholic beverages registered a higher-than-expected outcome for August 2018.

Nearly 77% of the items in the consumer inflation basket registered inflation below the upper end of the 3% to 6% inflation target in August 2018, compared to a 62% average recorded since the beginning of 2016. Half the items in the basket, on a weighted basis, recorded inflation below 3% in the same period.

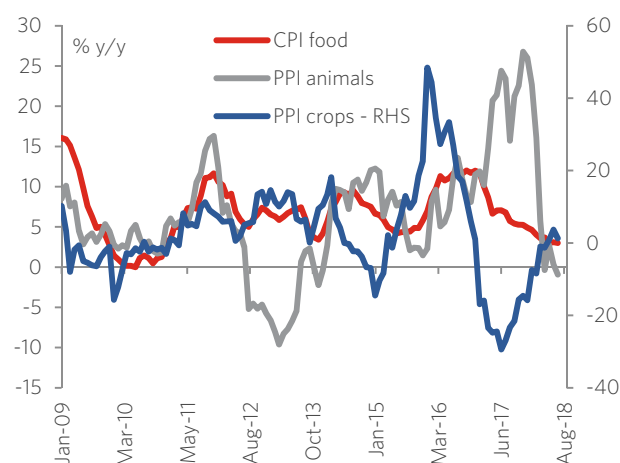
Subdued food inflation should gradually tick higher in upcoming quarters

Food inflation fell by 0.3% in August 2018, relative to the previous month and increased by only 2.9% in year-on-year (y/y) terms. Processed food inflation helped to pull overall food inflation lower, with prices in this category increasing by 1.9% y/y, whereas prices of unprocessed foods rose by a 3.7% in the corresponding period.

Deflation continued in the bread and cereals category, with prices falling 2.2% in August 2018 relative to a year ago. Although meat prices increased by 5.3% in the same period, meat inflation has come down significantly from the 15.6% rate recorded in September 2017. Meat inflation could fall further in line with a recovery in slaughtering rates. Slaughtering rates fell in 2017 as farmers rebuilt their herds following increased slaughtering rates in 2016, due to a shortage of grazing pastures and high animal feed costs related to the drought.

Crop prices at the producer level have recorded positive inflation in the past three months, signalling a reversal in deflation pressures. This could possibly signal a bottoming out of bread/cereal inflation at the consumer level in upcoming months (see chart 2 and 3). Price increases at the consumer level generally lag prices at the producer level by between three and six months.

Chart 2: A reversal in crop price deflation



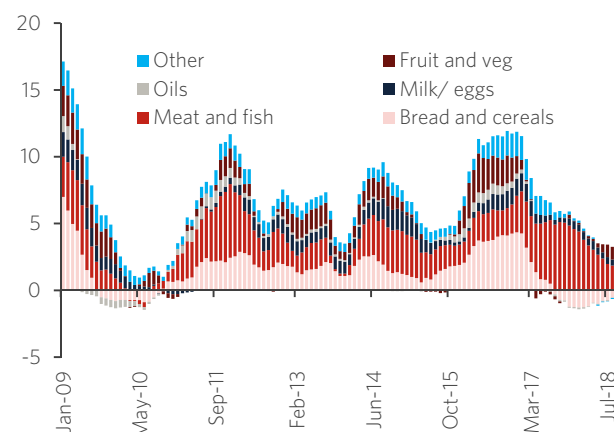
Source: Stats SA, Global Insight, Momentum Investments

Subdued food inflation has lowered price pressures for low-income earners

The bottom 30% of income earners in SA have been experiencing lower rates of inflation relative to the top 30% of income earners since March 2017. The gap extended to 2.5%

Producer price inflation for the animal category (see chart 2) dipped into negative territory for July 2018, further highlighting the prospect of lower meat inflation at the consumer level in the near term.

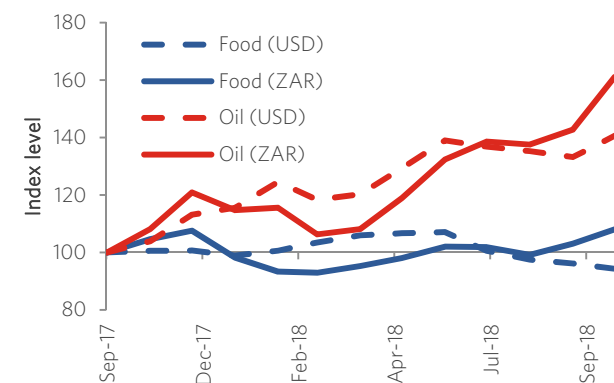
Chart 3: Contribution to food inflation (% y/y)



Source: Stats SA, Global Insight, Momentum Investments, data up to August 2018

Relative to a year ago, food prices are 8% higher in rand terms, whereas oil prices pose a far larger threat, more than 60% higher relative to a year ago (see chart 4).

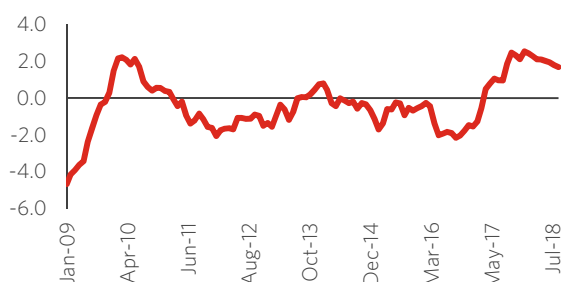
Chart 4: Oil prices are a threat to the inflation outlook



Source: Stats SA, Global Insight, IRESS, Momentum Investments

at its peak in December 2017, but has since narrowed to 1.7% in August 2018 (see chart 5).

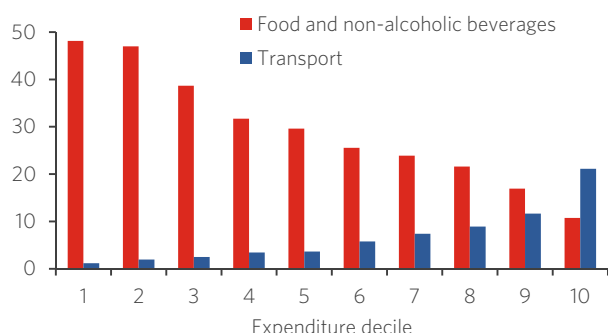
Chart 5: Inflation gap (high minus low-income earners, %)



Source: Stats SA, Global Insight, Momentum Investments, data up to August 2018

This discrepancy is largely owed to the different consumer baskets for the various income groupings in SA. Chart 6 shows food and non-alcoholic beverages account for a larger portion of spend for lower income earners, while the transport component constitutes a larger share of total consumer spend by the richer income-earning deciles.

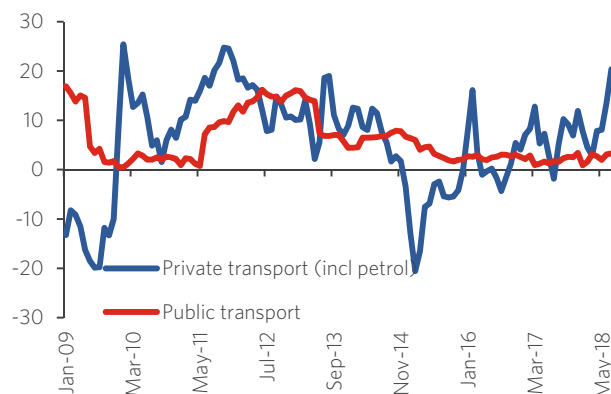
Chart 6: Consumer basket weightings per expenditure decile (%)



Source: Stats SA, Global Insight, Momentum Investments

Public transport accounts for 2.3% of the overall basket (split between rail, road (predominantly) and air), while private transport includes costs for personal vehicle operation (spares, fuel, maintenance) and accounts for 5.9% of the overall consumer basket. Public transport, on which the lower income-earning deciles are largely reliant, increased by 3% y/y in August 2018, while private transport increased by 19.2% y/y (see chart 7).

Chart 7: CPI per income-earning decile (% y/y)



Source: Stats SA, Global Insight, Momentum Investments, data up to August 2018

Muted core and services inflation, but administered price pressures picked up

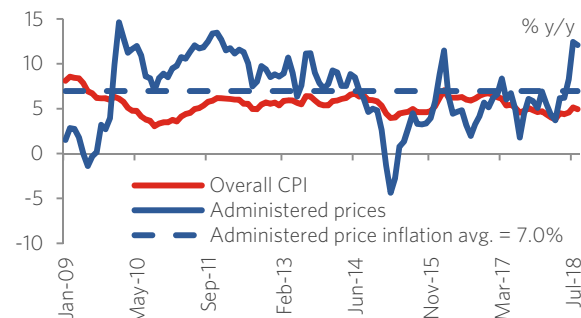
Inflation, excluding the effect of volatile food/beverages and fuel/energy prices, dipped back down to 4.2% y/y in August 2018, from 4.3% y/y in July. Lower services inflation (including the lowest rental inflation since the new survey began in January 2009) likely contributed to lower core inflation, given its relatively high weighting in the consumer inflation basket.

Services inflation has printed below 6% for the last 30 months and has averaged 5.0% during the past three months, closely in line with goods inflation.

Administered prices, on the other hand, showed signs of increasing price pressure. This category, which accounts for nearly 15% of the overall consumer price basket,

increased at 12.1% y/y in August 2018 (see chart 8), almost double the rate recorded for the past 12 months on average.

Chart 8: Administered price inflation (% y/y)



Source: Global Insight, Momentum Investments, data up to August 2018

Interest rates expected to remain on hold at the upcoming MPC meeting

Headline inflation is expected to rise, but should remain within the target band in the medium term. Although low food inflation and a dulled rate of currency pass-through have kept inflation outcomes surprising to the downside, the rand, international oil prices and electricity tariffs are still viewed as the major upside threats to the inflation outlook.

While weaker-than-anticipated growth outcomes could delay the first interest rate hike to the beginning of 2019, it will remain necessary to maintain a healthy real interest rate level in an environment where global liquidity additions are shrinking. A shallow interest rate hiking cycle is anticipated, as the SA Reserve Bank continues to urge inflation expectations closer to the midpoint of the target band.

