The Macro Research Desk

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Inflation positively surprises consensus at 4.5% in March 2019

Highlights

- Headline and core measures of inflation rose to 4.5% and 4.4% in March 2019, positively surprising consensus expectations of 4.7% and 4.5%, respectively.
- 70% of the items in the consumer inflation basket recorded inflation below 6% in March 2019, indicating little sign of broad-based inflationary pressure.
- There is an indication of further meat price deflation at the producer price level, but crop inflation is pointing to higher bread and cereal prices in the near term.
- The Central Energy Fund is guiding towards another sizeable rise in the fuel price for May 2019, with the current under-recovery amounting to 53c/l.
- Rental inflation surprised to the downside at 2.7% in March 2019. This was the lowest reading on record since the major basket reweighting and methodological changes, which were incorporated in 2008.
- Notwithstanding within-target inflation and subdued growth outcomes, the South African Reserve Bank (SARB) is likely looking for a further confirmation of a sustained downward trajectory in inflation expectations. As such, the bar to interest rate cuts is likely still high and, as such, interest rates should remain steady in the near term.

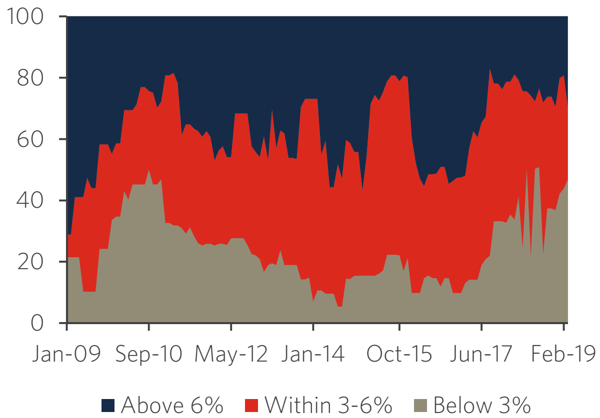
Another positive inflation surprise in March 2019

According to Statistics (Stats) SA consumer price inflation (CPI) jumped from 4.1% in February 2019 to 4.5% in March 2019, but came in below expectations for a rise to 4.7%.

Since the start of 2016, headline and core inflation has only exceeded market expectations for a fifth of the time, suggesting that inflation has largely surprised the market to the downside in recent months. This has mostly been due to lower-than-expected food inflation, a supressed pass-through from a weaker currency and contained services inflation.

The headline index shifted 0.8% higher between February and March 2019, with transport costs and price increases related to sin taxes (announced in February's 2019 national budget) contributing the most to the monthly change.

Chart 1: Inflation dispersion (%)



Source: Stats SA, Global Insight, Momentum Investments, data up to March 2019

Your goal is our benchmark

momentum investments

March is generally a high-surveyed month. Around a quarter of the basket was surveyed in addition to the regular surveys conducted monthly. Relative to Momentum Investments' forecasts, vehicle and rental inflation surprised the most to the downside, while inflation in tobacco, personal care and public transport registered a higher-than-expected outcome.

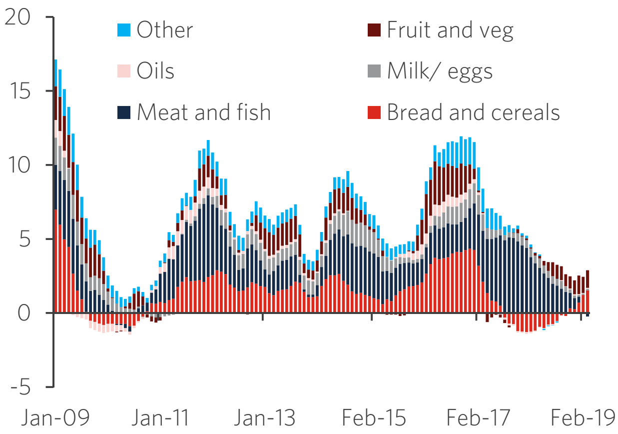
More than 70% of the items in the consumer inflation basket (on a weighted basis) registered inflation below the upper end of the 3% to 6% inflation target in March 2019, indicating little sign of broad-based inflation pressure. Inflation in categories printing above 6% in March 2019 included water tariffs (11%), non-alcoholic beverages (10.2%), electricity (7.6%), private and public transport (9% on average), education (6.7%), insurance (6.6%) and alcoholic beverages (6.5%) (see chart 1).

Big divergence in meat and bread/cereal inflation

Food inflation ticked higher from 2.3% to 2.4% in March 2019, driven by price trends in bread/cereals (6.1%), fruit (7.6%) and vegetables (9.4%). Meanwhile, meat prices deflated for a second month in a row (negative 1.1%). While meat prices were a large driver of food inflation during 2017 and 2018, the contribution has become negative (see chart 2).

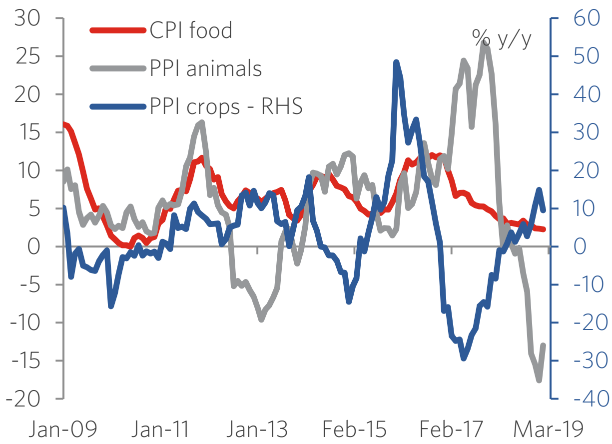
Price trends at the producer level indicate the divergence between meat and bread/cereal prices is likely to persist in the short term. Crop inflation at the producer level increased by 9.5% in March 2019, pointing to additional upward pressure on bread and cereal prices in the near term, while animal prices were 13% lower than a year ago (see chart 3).

Chart 2: Contribution to food inflation



Source: Stats SA, Global Insight, Momentum Investments, data up to March 2019

Chart 3: Further downside in meat inflation



Source: Stats SA, Global Insight, Momentum Investments

Price pressure in the transport categories

Petrol prices increased by 74c/l (Gauteng 95) in March and by a larger 131c/l in April 2019 (which included a 5c/l increase in the general fuel levy and a 20c/l hike in the Road Accident Fund levy). The under-recovery calculated between 29 March and 16 April 2019 points to a further 53c/l increase in the fuel price for May 2019.

Public transport prices were surveyed in March 2019 and recorded a 1.4% increase relative to February. Public transport prices are 10% higher than where they were a year ago.

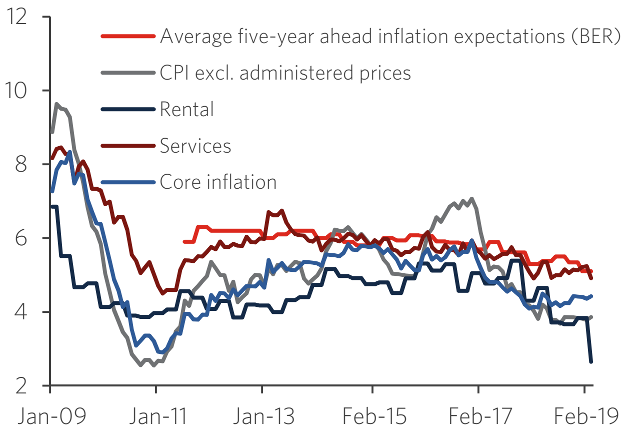
Muted underlying inflation

Core or underlying inflation has remained muted at 4.3% on average in the past 12 prints, in line with subdued local demand. After remaining sticky at 6%, inflation in the services category has also edged lower, since 2015, to 4.9% in March 2019 (see chart 4).

One of the key drivers of services inflation is rental inflation, which accounts for nearly 17% of the consumer basket. Inflation in this category grinded lower to 2.7% in March 2019, which was the lowest reading on record since the major basket reweighting and methodological changes were incorporated in 2008.

Previously, inflated property prices in pockets of Gauteng and the Western Cape drove overall rental inflation higher, but, since these prices have moderated, inflation in this category has lessened. The SARB has noted the persistent downside surprises in underlying and services inflation measures, but has warned it is too early to conclude these changes are structural in nature.

Chart 4: Little demand-pull inflation pressure



Source: Stats SA, Global Insight, Momentum Investments, data up to March 2019

Interest rates likely to remain steady at the upcoming interest-rate setting meeting

Positive trends in services inflation and other measures of underlying inflation have led to an eventual downward adjustment in inflation expectations of businesses and labour, which resulted in average five-year ahead inflation expectations edging to its lowest level on record (since 2011) at 5.1% (see chart 4).

In Momentum Investments' opinion, the positive downward trajectory in inflation expectations and weaker-than-expected growth outcomes likely lower the pressure on the SARB to maintain a tightening bias.

Nonetheless, in the firm's view, the hurdle to interest rate cuts remains high, given the SARB's intention to drive inflation expectations closer to the midpoint of the target band on a sustainable basis to allow for more room to manoeuvre in the event of external shocks. Moreover, looser fiscal policy is inhibiting the SARB's ability to run more accommodative policy and should contribute to a steady stance on monetary policy in the coming quarters.