



# The Macro Research Desk

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## Inflation beats expectations and edges lower to 4.4% in April 2019

### Highlights

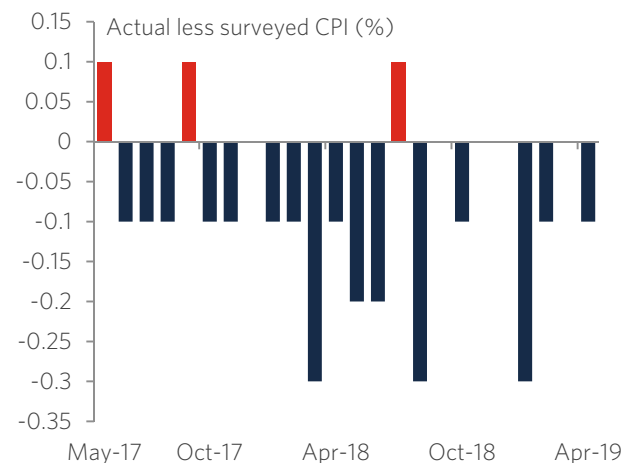
- Headline inflation dropped to 4.4% in April 2019, beating expectations for a steady outcome of 4.5%. Core inflation dropped in line with the IRESS consensus to 4.1% from 4.4% previously.
- More than three quarters of the items in the consumer inflation basket recorded inflation below 6% in April 2019, confirming a lack of widespread inflationary pressure.
- Meat prices continued to deflate at the producer price level, while the rise in crop inflation slowed in the latest reading for March 2019.
- A small cut in the fuel price is expected for June 2019, with the over-recovery amounting to 6c/l.
- Services inflation fell to its lowest level in seven years.
- Administered price inflation remained outside of the 3% to 6% inflation target and rose to 8.3% in April 2019.
- Notwithstanding a continual string of downside surprises in inflation and disappointing growth outcomes, the South African Reserve Bank (Sarb) noted the need for further confirmation of a sustained downward trajectory in inflation expectations, closer to the midpoint of the target range. As such, Momentum Investments expects interest rates to remain steady at the upcoming interest-rate-setting meeting.

### Inflation beats consensus expectations for April 2019

Headline inflation dropped to 4.4% in April from 4.5% in March 2019, positively surprising market expectations for a sideways movement. The 0.6% rise in consumer prices in the month was largely attributable to petrol prices, which jumped R1.31/l for 95 Octane. This steep increase included an adjustment to the basic fuel price, fuel levies of 15c/l, Road Accident Fund levies of 5c/l and an 11% increase in pipeline transport costs as announced by the National Energy Regulator of SA (Nersa).

Headline inflation only surprised negatively to the upside in three readings in the past two years thanks to lower-than-expected food inflation, a suppressed pass-through from a weaker currency and contained services (including rental) inflation.

Chart 1: String of positive inflation surprises

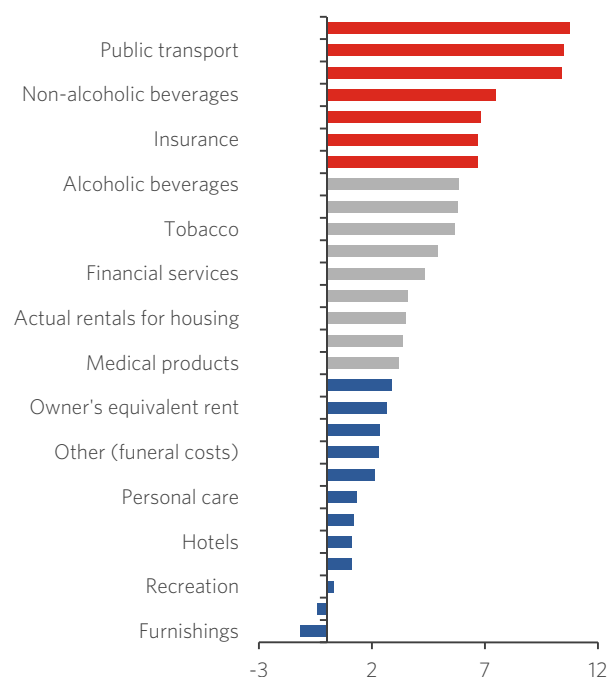


Source: Stats SA, Global Insight, Momentum Investments

April is generally a low-surveyed month. Around 12% of the basket was surveyed in addition to the regular surveys, which are conducted monthly. Additional items surveyed included funeral costs, gym fees, sports tickets and television licenses. The effect of the sin taxes (tobacco and alcohol) announced in the February national budget was also captured in the April reading. Relative to Momentum Investments' forecasts, hotel, funeral costs and public transport inflation surprised the most to the downside, while inflation in insurance registered a higher-than-expected outcome.

More than three quarters 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 April 2019, suggesting widespread inflation pressure is not present in the consumer basket. Inflation in categories printing above 6% in March 2019 included water tariffs (10.8%), private and public transport (10% on average), non-alcoholic beverages (7.5%), electricity (6.7%), insurance (6.7%) and education (6.7%) (see chart 2).

Chart 2: Inflation per category (%)



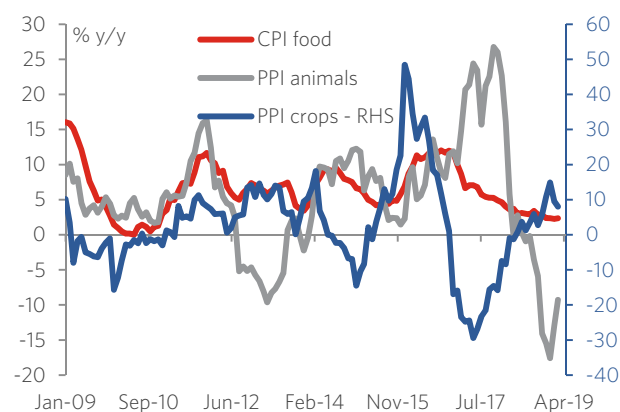
Source: Stats SA, Global Insight, Momentum Investments, red = above target, blue = below target, grey = within target

### Producer-level meat and crop inflation point to moderate food inflation at the consumer level

Food inflation stabilised at 2.4% in April 2019. Food prices inched 0.1% higher in the month, driven by fish (0.9%) and vegetable prices (1.5%), while prices for sugar (negative 0.3%) and fruit (negative 4%) dropped. Meat prices were unchanged in the month.

(see chart 3). Although the rate of meat price disinflation slowed to negative 9.3% in March 2019, this continues to point to downward pressure on meat prices at the consumer level in the near term, but offsetting factors may be on the horizon.

Chart 3: Food inflation at the producer level



Source: Stats SA, Global Insight, Momentum Investments

Crop inflation at the producer price level declined in the latest data for March 2019 to 8% from a peak of 14.9%

The decline in meat inflation was a direct result of local suppliers increasing supply to the local market given the ban on meat exports by neighbouring countries, due to the outbreak of foot-and-mouth disease. However, with conditions normalising, the lifting of the ban on exports should drive meat inflation higher from here.

BusinessLive reported the SA Poultry Association (Sapa) released a report in January, suggesting Brazil accounted for 61.5% of SA's chicken imports in 2018, followed by the United States at 16.1% and the European Union at 12.6%. Sapa has applied to the International Trade Administration Commission of SA to hike tariffs on chicken to 82%, which could raise chicken prices by 32%. This increase could drive meat inflation higher in the coming months.

## Mild alleviation expected in the petrol price for June 2019

Petrol prices increased by R1.31c/l (95 Octane) in April 2019, leaving private transport inflation at 10.4%. Petrol prices rose by 54c/l in May, but a current over-recovery between 26 April and 21 May 2019 hints at a cut of 6c/l in June.

Inflation in the public transport category (which includes taxi, bus, train and air fares) has tracked above the upper end of the 3% to 6% inflation target band for the past eight months to 10.5% in April 2019. Public transport inflation is likely to remain elevated in the near term.

## Services inflation at its lowest in nearly seven years

Core or underlying inflation fell to its lowest level in more than a year, at 4.1%, reflecting subdued domestic demand. Inflation in services dipped encouragingly to its lowest level in nearly seven years to 4.6% (see chart 4). Rental inflation, which is a significant component of services inflation, remained muted at 2.7%.

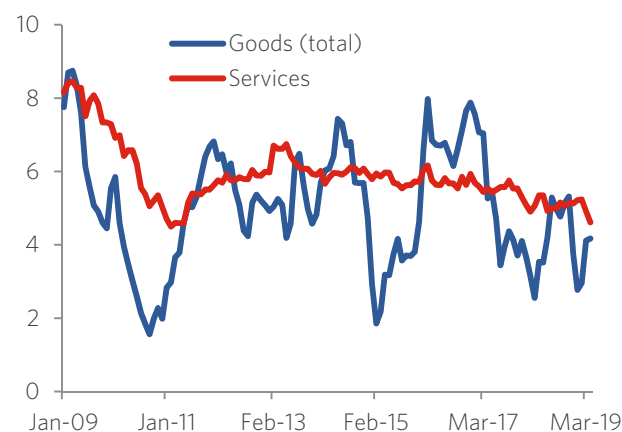
Previously inflated property prices in pockets of Gauteng and the Western Cape drove overall rental inflation higher, but since these prices have moderated, inflation in this category has lessened. The Sarb noted the persistent downside surprises in underlying and services inflation measures, but warned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

Administered price inflation remained stuck above the 6% upper target at 8.3% in April 2019, from 7.9% the

The international price of oil has climbed from US\$52/bbl at the end of 2018 to US\$72/bbl in May 2019, on the back of ongoing economic malaise in Venezuela and fears about oil supply from the Middle East. Nevertheless, the United Arab Emirates and Saudi Arabia stated they are prepared to cover any shortfall from Iran and with lower demand expectations, a major spike in the price of oil should be prevented.

month before. After excluding administered prices, inflation was recorded at 3.7% in April 2019 and at an average of 3.8% for the past year.

Chart 4: Services inflation heading lower (%)



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

## Expecting no change in interest rates at the upcoming interest-rate setting meeting

In its Monetary Policy Review for April 2019, the Sarb reiterated its preference for inflation expectations to be closer to the midpoint of the 3% to 6% target to contribute to broader macroeconomic stability. The Sarb suggested, at 4.5%, inflation should help with the cost of living and the country's overall competitiveness should be improved in the long run, with local inflation tracking more closely in line with that of SA's trading partners.

Inflation expectations are affected by recent inflation prints, but also the credibility of the Sarb's commitment to its inflation target. The Sarb acknowledged its recent communications conveying this message have had a positive effect on inflation expectations, which have moderated. Moreover, actual headline inflation has averaged 4.7% in the past two years, which is meaningfully below the upper end of the targeted range.

Momentum Investments' view that it is too early to consider an interest rate cut is premised on the Sarb's admission that it is premature to conclude that inflation has permanently adjusted lower. During this period, food inflation averaged 4.2%, while low global inflation, generally well-behaved international oil prices and a broadly stable exchange rate further contributed to subdued inflation prints. Rental and services inflation have also moderated, partly in response to slow growth in domestic demand and has supported lower prints in overall inflation.

Though inflation expectations, as surveyed by the Bureau of Economic Research, have moderated, the average expected rate of headline inflation for the next five years is still at 5.2%. For actual headline inflation to settle closer to the midpoint of the target range, lower inflation expectations need to be seen on a sustainable basis.

As such, despite a weak growth environment and downtrodden business and consumer sentiment, Momentum Investments expects interest rates to remain steady at the Sarb's upcoming interest-rate-setting meeting.

