momentum investments

in the moment

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Inflation contained and unchanged at 4.5% in June 2019

Highlights

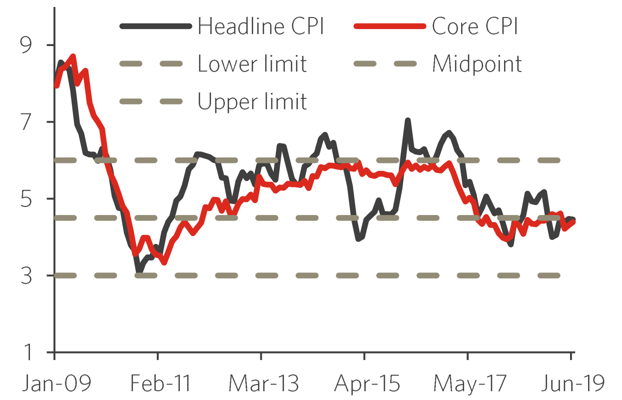
- Headline consumer price inflation (CPI) remained unchanged at 4.5% while core inflation inched higher to 4.3% in June 2019.
- The main contributors to headline inflation included housing and utilities, transport and food, which added 1.2%, 0.8% and 0.6% respectively in June 2019.
- Administered price inflation slowed to 6.9% (below the 7.1% average), driven by a softer contribution from fuel prices.
- Food inflation rose above the lower band of the target range to 3.2% in June 2019 from 2.8% in May 2019, largely driven by an uptick in meat prices.
- Services inflation increased to 4.8% in June 2019 while rental inflation remained below the midpoint of the target range.
- Momentum Investments expects inflation to remain contained close to the midpoint of the target range in 2019 and 2020 on weak demand-pull price pressures.

Inflation remained at the midpoint of the target range in June 2019

Headline CPI published by Statistics South Africa (Stats SA) remained unchanged at 4.5% in year-on-year (y/y) terms in June 2019. The quarterly print surprised at marginally higher than the South African Reserve Bank's (Sarb) 4.4% y/y expectation for the second quarter of 2019. Inflation increased by 0.4% in month-on-month (m/m) terms in June 2019 from a softer 0.3% m/m rate in May 2019.

Core (underlying) CPI inched higher to 4.3% y/y from 4.1% y/y in May 2019. Both measures of inflation have trended around the midpoint in recent prints, mirroring lower inflation expectations (see chart 1).

Chart 1: Headline and core inflation close to midpoint (% y/y)

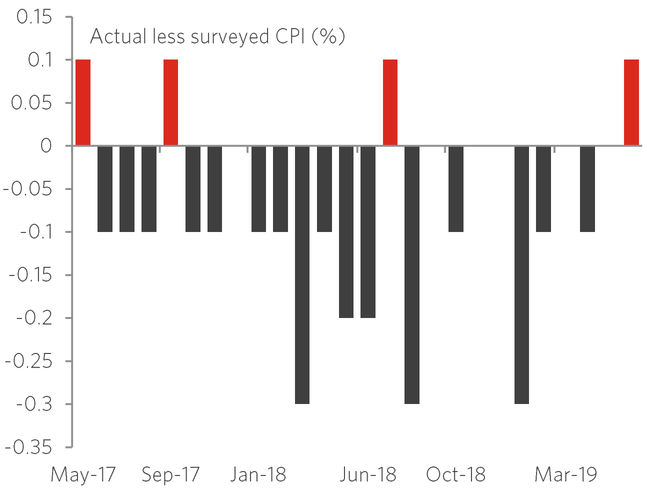


Source: Stats SA, Momentum Investments

A significant portion of the basket is surveyed in June, including actual rentals, which carries the largest weight, followed by motor vehicle insurance, domestic worker wages and transport fees (bus, train and taxi fees).

Although inflation for June surprised by being higher than the consensus expectation, the print remained at the midpoint of the target range (see chart 2).

Chart 2: Inflation surprised to the upside in June 2019



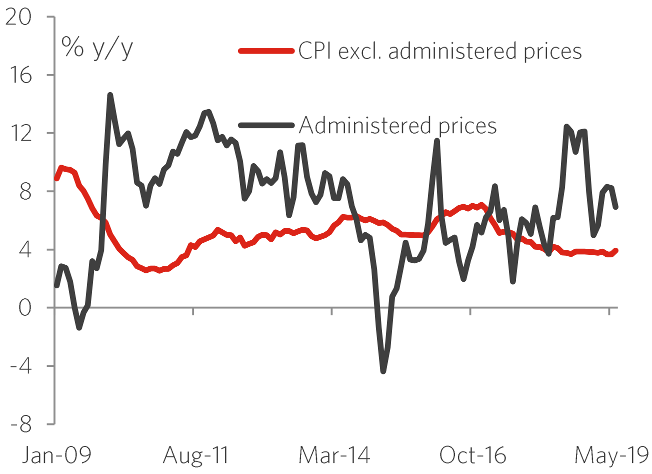
Source: Stats SA, Momentum Investments

The main contributors to headline inflation included housing and utilities, transport and food, which added 1.2%, 0.8% and 0.6% respectively in June 2019.

Administered price inflation slowed to 6.9% y/y in June 2019 from 8.2% y/y in May 2019, finally trending below the longer-term average of 7.1% y/y.

The decline in inflation emanated from the slowdown in fuel price inflation, adding only 2.3% in June 2019 from 3.5% previously. Motor vehicle registration fees and cell phone fees subtracted 0.1% from the 6.9% y/y June print. CPI excluding administered prices remained below the 4.5% midpoint, highlighting little demand-pull price pressure from the rest of the items in the consumer basket (see chart 3).

Chart 3: Administered prices show slight moderation



Source: Stats SA, Momentum Investments

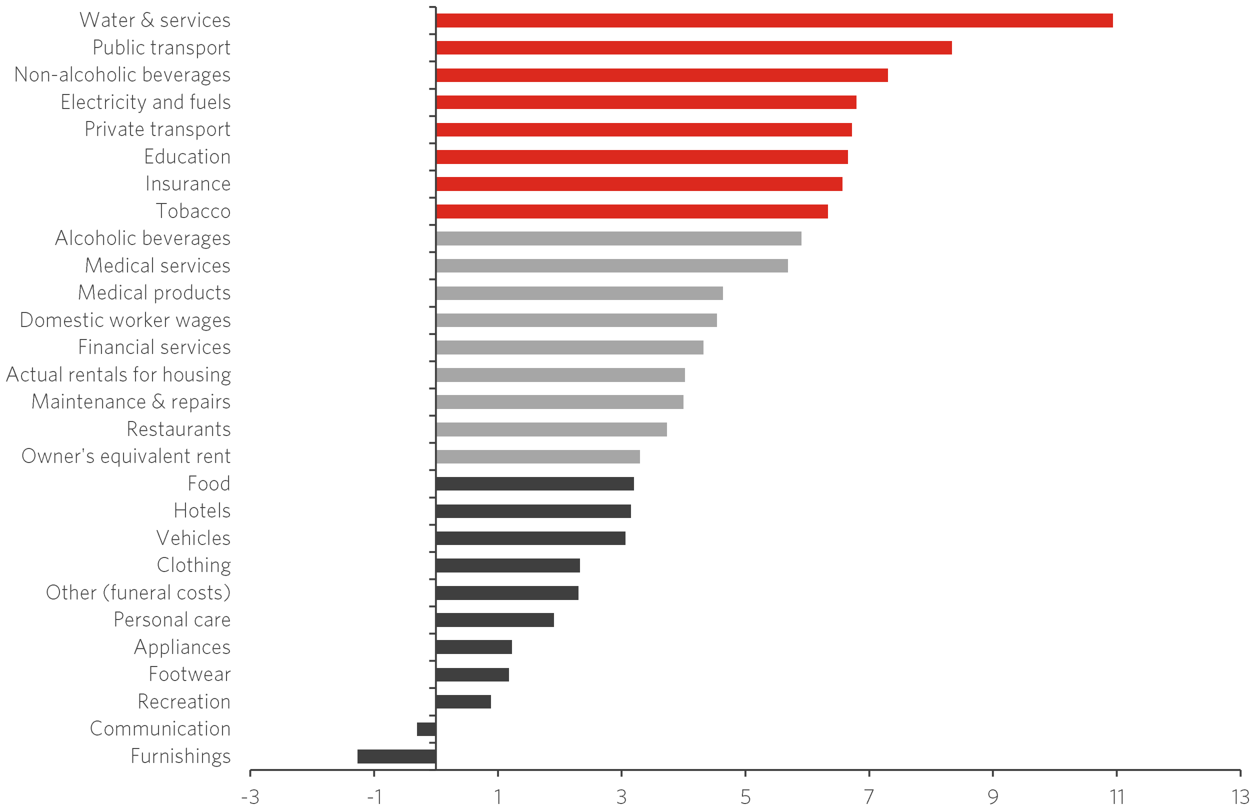
The bulk of administered prices still breach the upper limit of the target range

Inflation in most administered prices breached the 6% upper limit, led by water and services showing a 10.9% y/y increase in June 2019, followed by public transport, which is significantly affected by fuel prices (see chart 4). Services inflation remained well within the 3% to 6% target range, while food inched above the lower band of the 3% to 6% inflation target range in June 2019. The Sarb's assumption on world food price inflation was revised down to 0.6% in 2019 (previously 0.9%) and 1.6% in 2020 (previously 2.6%) while it kept 2021 unchanged at 1%.

The petrol price increased by 9 c/l in June 2019. This was the main driver of transport's 0.8% contribution to the headline figure. The fuel price grew by a softer 7.4% y/y from a more robust 11.4% y/y in May 2019. This will likely have a reversed effect in July 2019 as the petrol price declined at the start of July 2019. The Sarb has revised its assumption for the Brent crude price downward to US$67/bbl in 2019 from US$69/bbl, while it kept its assumption for 2020 and 2021 unchanged at US$68/bbl.

The Central Energy Fund has under-recovered the price by 12.6 c/l for the period between 28 June 2019 and 23 July 2019, supported by a more resilient exchange rate. Therefore a mild cut in the price of petrol is expected in August.

Chart 4: Inflation per category (% y/y)



Source: Stats SA, Momentum Investments

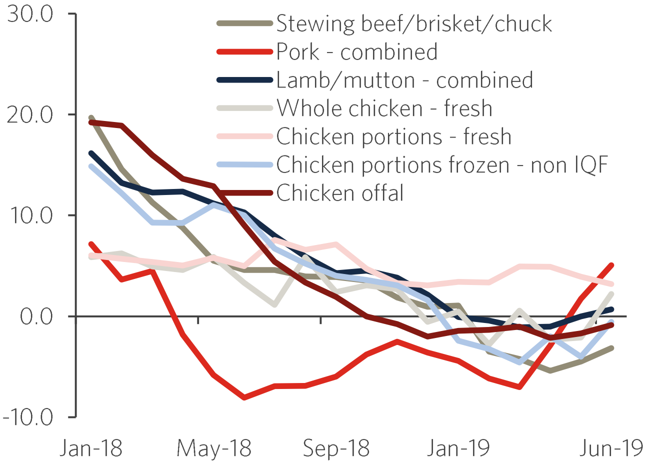
Food inflation exceeds the lower limit of the target range in June 2019

Food inflation rose above the lower band of the target range to 3.2% y/y in June 2019 from 2.8% y/y in May 2019. This was largely driven by an uptick in meat prices, which grew to 1.2% y/y from 0.3% y/y. The domestic oversupply in meat is fading now that the majority of the meat export lines have been reopened following a lifting of the foot-and-mouth disease export ban. The basket of meat prices showed a steady rise across the board, with the price of pork having jumped significantly to 5.1% y/y in June 2019 from 1.7% in May 2019 (see chart 5). The price of fish also inched slightly higher to 6.0% y/y from 5.9% y/y in May 2019.

Bread and cereals inflation showed a mild moderation to 7.3% y/y from 7.8% y/y in June 2019. Inflation for desserts increased significantly to 8.2% y/y in June 2019 from 6.8% y/y in May 2019, levels last seen in August 2017.

Momentum Investments expects food inflation to rise above 5% in 2020.

Chart 5: Uptick in meat inflation (% y/y)



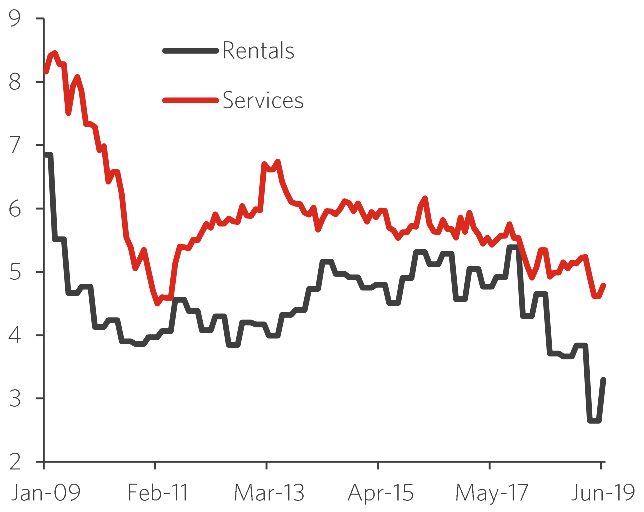
Source: Stats SA, Momentum Investments

The Food and Agriculture Organization (FAO) expects world food prices to rise in 2019 to an average of 1% from a 4% contraction in 2018.

Services and rental inflation inched higher

Services inflation increased in June 2019 to 4.8% y/y from 4.6% y/y in May 2019 while rental inflation moved up to 3.3% y/y from 2.6% y/y in May 2019 (see chart 6). Although services inflation is above the midpoint of the target, the print is still below the 6% upper limit. The Sarb has offered the oversupply of residential rental space as a partial explanation to the drop in rental inflation.

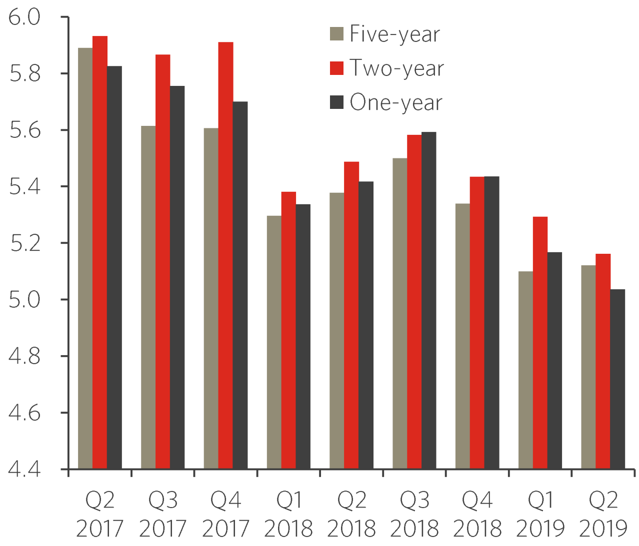
Chart 6: Mild uptick in services and rental inflation (% y/y)



Source: Stats SA, Momentum Investments

The Bureau of Economic Research (BER) inflation survey showed a decline for the one- and two-year ahead inflation expectations in the second quarter of 2019. The one-year ahead inflation expectation survey eased from 5.2% y/y to 5% y/y in the second quarter of 2019. The two-year ahead inflation expectation dropped to 5.2% y/y from 5.3% y/y in the first quarter. The average five-year ahead inflation expectation remained unchanged at 5.1% between the first and the second quarter of 2019. Inflation expectations for all three series have however remained within the target range and are moving towards the midpoint (see chart 7).

Chart 7: Inflations expectations trending lower (%)



Source: Sarb, Momentum Investments

Mild consumer sentiment has manifested in a depressed residential property market, which has coincided with muted rental inflation and to some extent subdued services inflation.

Inflation likely to remain benign for the rest of the year

In its July 2019 Monetary Policy Committee (MPC) meeting, the Sarb revised its inflation forecast for 2019 and 2020 downward, and explained this move by a slower rise in electricity, fuel and food prices. The Sarb also reduced the repo rate to 6.50% from 6.75% in the same meeting, citing weak demand and lower inflation outcomes. This cut will likely induce some spending, but the wider negative output gap suggests no major rebound in demand-pull inflation measures in the near to medium term.

Despite cutting interest rates by 25 basis points, in line with market expectations, the Sarb signalled a cautious approach to further interest rate moves. This was indicated by the lack of a discussion on a larger interest rate cut of 50 basis points at the July 2019 interest-rate-setting meeting and the view of the quarterly projection model, which highlighted only one cut before the end of the year. Nonetheless, inflation excluding administered prices remains non-threatening at an average of 3.8% for the past twelve readings. Similarly, services inflation remains within reach of the midpoint of the target, despite a marginal uptick in the latest print. Furthermore, average five-year ahead inflation expectations as calibrated by the BER remained at its lowest point since the beginning of the survey, at 5.1% in the second quarter of the year.

In Momentum Investments' view, low growth and well-behaved inflation outcomes leave the door open for a further reduction in interest rates. Interest rate cuts in many other emerging economies leave South Africa's real interest rates looking attractive on a relative basis, further pointing to space for a further cut in interest rates. This cycle is however likely to remain shallow, given the need to boost growth through the implementation of structural reforms, rather than through more aggressive monetary policy stimulus.

The International Monetary Fund (IMF) has indicated that central banks globally have paused their monetary normalisation activity in the wake of slower growth and disinflation in its July 2019 World Economic Outlook (WEO) report.

More accommodative monetary policy globally could present inflationary pressure in the medium term. Inflation is estimated at 4.8% (previously 4.7% in the April WEO forecast) for 2019, and unchanged at 4.0% in 2020 for emerging markets, according to the WEO July 2019 update. Advanced economies are projected to see inflation rise to 1.6% in 2019 and 2.0% in 2020 (previously 1.9% in the April WEO forecast).

Momentum Investments expects local inflation to average close to the midpoint of the inflation target range in 2019 and 2020, barring no supply-side shocks (including a blowout in the oil price or sustained currency depreciation).