momentum investments

in the moment

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Inflation eased in line with expectations in November 2019

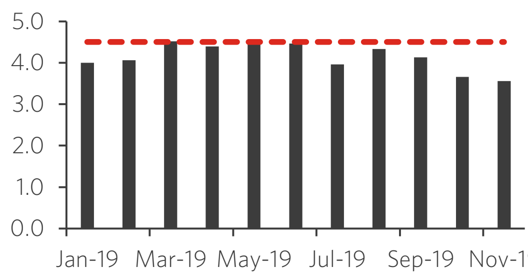
Highlights

- The Consumer Price Index (CPI) for November 2019 eased further to 3.6% from 3.7% in October 2019.
- The November number was in line with the Iress expectation, which dropped to 2011 lows.
- The drivers for the November 2019 number reflected those observed in October 2019. A lower contribution by transport inflation explained the lower annual percentage change in inflation.
- Services inflation also remained unchanged at 4.2% since September 2019. Meanwhile, goods inflation dropped further in November 2019 to 2.8% from 3.1% in October 2019.
- Although administrative prices eased further, administrative prices excluding fuel and paraffin remained above the 6% upper limit of the inflation target at 7.4%, highlighting that the slowdown in administrative prices has been the result of easing fuel prices.
- In November 2019, transport inflation dipped into negative territory to 0.3% from 0.3% in October 2019. Inflation is now at a four year low.
- Food inflation remained unchanged at 3.5% between October 2019 and November 2019, underpinned by a larger share of prices in the food basket contracting.
- The outlook for rising food inflation, higher fuel prices and higher prices for structural inefficiencies (such as electricity and water supply) remain upside risks to the inflation outlook, which we expect to increase from 4.2% in 2019 to 4.6% in 2020.

Inflation below the midpoint of the target for longer

Statistics South Africa (Stats SA) released the CPI number for November 2019, which eased further to 3.6% in year-on-year (y/y) terms from 3.7% (y/y) in October 2019 (see chart 1). The November number was in line with the Iress expectation, which dropped to 2011 lows. The November index rose by 0.1% in month-on-month (m/m) terms underpinned by a 0.15% contribution from the residual item (previously subtracting 0.1% in October 2019).

Chart 1: CPI slips further below midpoint (% y/y)

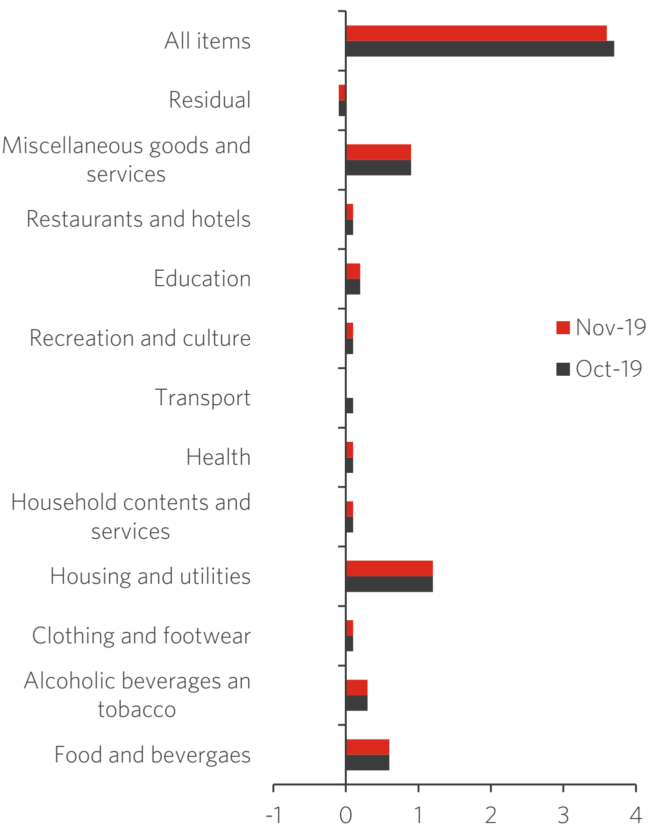


Source: Stats SA, Momentum Investments

Core inflation slowed to 3.9% y/y in November 2019 down from 4.0% y/y, slightly higher than the Iress expectation of 3.8%.

The drivers for the November 2019 number were similar to that of October 2019. A smaller contribution from transport inflation translated into lower headline inflation (see chart 2). Food and beverage inflation slowed further in November 2019 to 3.5% y/y from 3.6% y/y in October 2019. Inflation in housing and utilities and miscellaneous goods remained unchanged at 4.7% y/y and 5.7% y/y, respectively since September 2019.

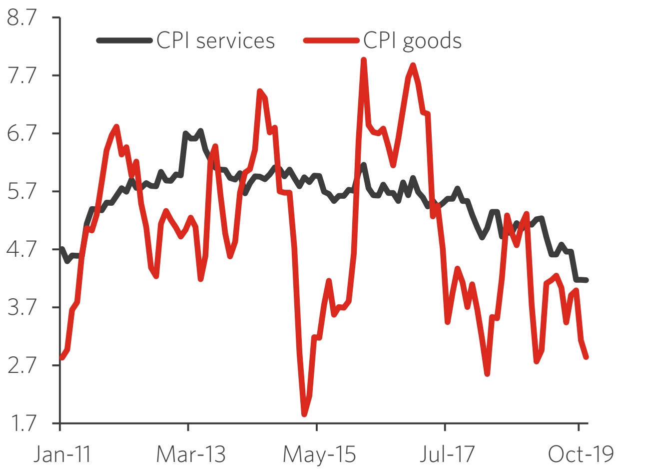
Chart 2: Contributions to annual percentage change (%)



Source: Stats SA, Momentum Investments

Similarly, services inflation also remained unchanged at 4.2% y/y since September 2019. Meanwhile, goods inflation dropped further in November 2019 to 2.8% y/y from 3.1% y/y in October 2019 (see chart 3). Prices for durable goods (mostly furniture) were the only increases in the overall goods category. Durables inflation rose to 2.4% y/y in November 2019, up from 2.2% y/y. Non-durable goods (food and fuel) inflation slowed further to 3.1% y/y from 3.5% y/y in October 2019. Semi-durable goods (clothing and footwear) inflation dropped to 1.9% y/y in November 2019 from 2.0% y/y in October 2019.

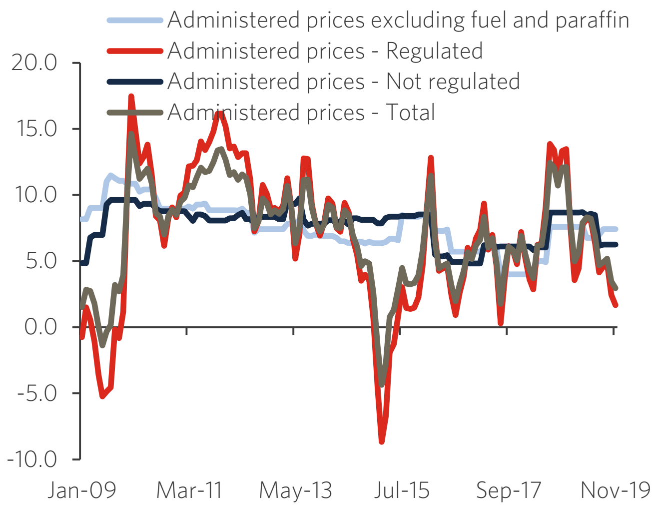
Chart 3: Services and goods inflation (% y/y)



Source: Stats SA, Momentum Investments, data up to November 2019

Administered price inflation fell to a new low in 2019 to 3.0% y/y in November 2019 from 3.5% y/y in October 2019. Fuel detracted by a significantly large 2.1% y/y, having previously detracted 1.6% y/y. However, inflation for administrative prices excluding fuel and paraffin remained above the 6% upper limit of the inflation target at 7.4% y/y, highlighting that the slowdown in administrative prices is the result of easing fuel prices.

Chart 4: Administered prices (% y/y)



Source: Stats SA, Momentum Investments

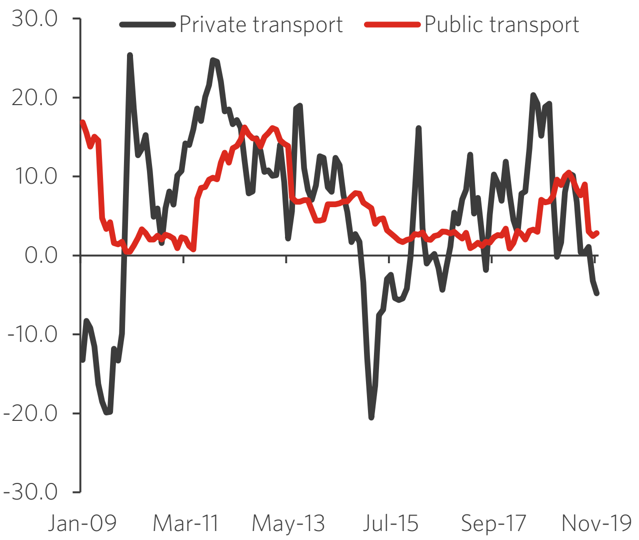
Regulated administered price inflation dropped to 1.7% y/y in November 2019 from 2.4% y/y. Non-regulated administered price inflation remained unchanged at

6.2% y/y since August 2019. This has slowed from 8.7% y/y reported in January 2019 (see chart 4). This will likely slow further in the medium term as data fees have been authorised to decline by between 30% and 50% by the Competition Commission.

Transport inflation continues to trend lower

In November 2019 transport inflation dipped into negative territory to 0.3% y/y from 0.3% y/y in October 2019. Private transport inflation reported a deeper contraction to 4.8% y/y in November 2019, previously contracting to 3.2% y/y in October 2019. This was explained by the contraction in fuel inflation to 6.6% y/y, previously contracting by 4.9% in October 2019. Public transport inflation, however, reverted to its upward trend in November 2019. The index rose 2.8% y/y, up from 2.5% y/y in October 2019 (see chart 5).

Chart 5: Private transport inflation dips further (% y/y)

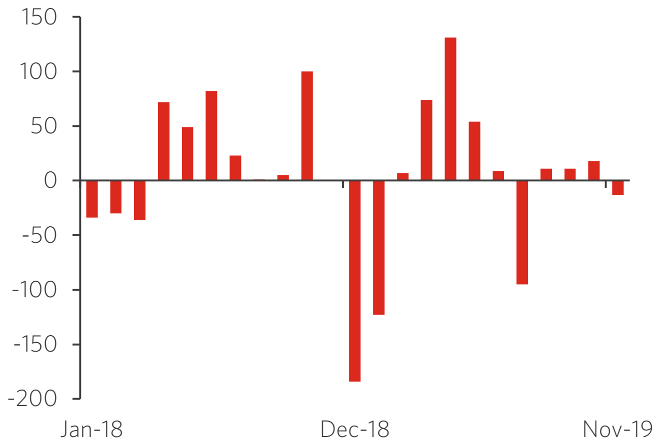


Source: Stats SA, Momentum Investments

In November 2019, fuel prices dropped by 13 c/l relative to no change in the fuel price in November 2018. Fuel prices, however, rose by 22 c/l in December 2019 in comparison to the R1.84/l decline experienced in December 2018.

The fuel price reprieve is likely to come to a halt from December 2019. The Organisation of the Petroleum Exporting Countries (Opec) and Russia agreed to cut oil production by an additional 500 000 barrels a day through to the end of March 2020 in an attempt to raise Brent crude prices (see chart 6).

Chart 6: Petrol price change (95 octane c/l)



Source: Iress, Momentum Investments

The South African Reserve Bank (Sarb) expects the oil price to soften to an average of US$65 bbl in 2019 from US$71 bbl in 2018. A mild increase to US$66 bbl for 2020 and 2021 is expected.

Food inflation not normalising yet, but likely in the near term

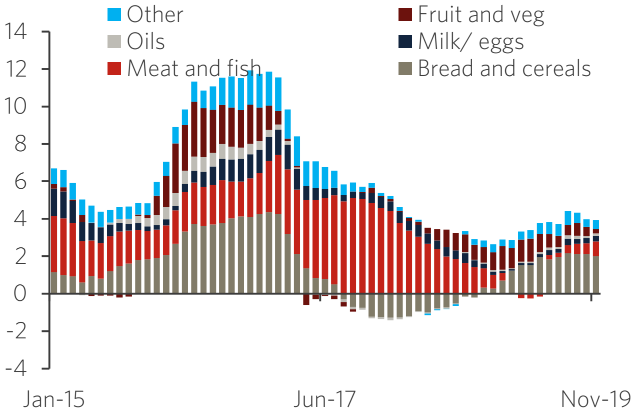
Food and non-alcoholic beverage inflation declined to 3.5% y/y in November 2019 from 3.6% y/y in October 2019. Food inflation remained unchanged at 3.5% y/y between October 2019 and November 2019, underpinned by a larger share of prices in the food basket contracting. Prices for fruits and vegetables, oils and milk and eggs added to the subdued food inflation print (see chart 7).

Meat inflation rose to 1.8% y/y in November 2019 from 1.1% y/y and increased by 0.3% m/m. The second outbreak of foot-and-mouth disease in 2019, which affected a total of

11 commercial properties in the Capricorn, Vhembe and Mopani districts in Limpopo, will likely contribute to lower meat inflation in the near term, given a continuation in the export ban of hoofed animals.

Milk and egg prices also rose marginally by 2.5% y/y, up from 2.4% y/y and reported a 0.2% m/m rise, previously contracting by 0.5% m/m in October 2019. Bread and cereal inflation decelerated to 8.0% y/y in November 2019 from 8.5% y/y in October 2019 but rose by 0.3% m/m (previously flat in October 2019). Sugar, sweets and dessert inflation rose to 3.3% y/y up from 2.9% y/y, alongside an increase in monthly momentum of 1.0% m/m, previously contracting by 0.1% m/m. Inflation on fruits declined in November 2019 to 3.6% y/y from 5.1% y/y in October 2019, however, the monthly momentum increased by 2.8% from 2.1% in October 2019.

Chart 7: Food inflation by contribution (%)



Source: Stats SA, Momentum Investments, data up to Nov 2019

Vegetable inflation showed some reprieve to 1.5% y/y from 3.6% y/y and slowed by 0.7% m/m (previously growing by 0.5% m/m).

Despite recent flooding in some areas of SA, the rains are late and the mid-October planting season was significantly dry. According to the Agricultural Business Chamber (Agbiz), SA experienced a double-digit contraction in maize production in the 2018/19 production season and this is likely to reoccur in the 2019/20 production season. SA is traditionally a maize exporter but will likely need to import if a decline in maize production occurs in 2020. This will result in higher bread and cereal inflation in the near to medium term but will likely be partially negated by the slower rise in meat inflation.

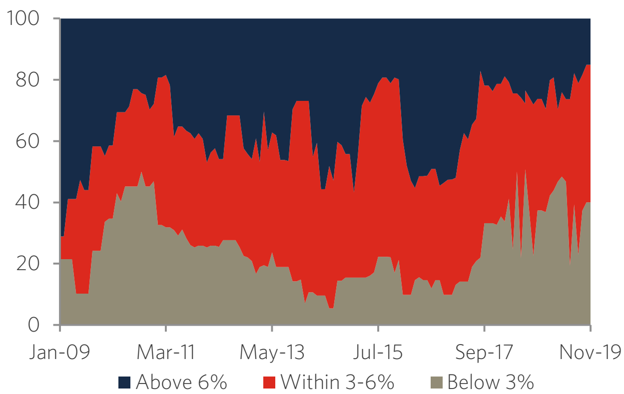
The Sarb still assumes world food prices will rise marginally by 1.5% in 2020 and slow to 1.0% in 2021.

Muted demand pull inflation underpinned by moribund consumer

Subdued inflation can be explained by 45% of the weighted items in the inflation basket trending within the 3% to 6% band and a significant 40% of the basket tracking below the lower 3% limit of the inflation target for the last two months.

Only 15% of the weighted items in the inflation basket breached the upper 6% of the inflation target, which is the lowest portion on record (see chart 8).

Chart 8: Inflation contained for longer (%)



Source: Stats SA, Momentum Investments

Household confidence remains anaemic, having dipped into negative territory in the third quarter of 2019. This weak confidence was reflected in household expenditure, which declined markedly in the third quarter of 2019 from a robust increase in the second quarter of 2019.

Anaemic consumer confidence and soft growth in household spending explain some of the weakness in inflation, but delayed normalisation in meat prices due to the foot-and-mouth outbreak and normalisation in fuel prices have also contributed to muted inflation numbers.

The Sarb expects headline inflation to average 5.1% in 2020 and to peak at 5.3% in the first quarter of 2020, but this remains above consensus. The outlook for rising food inflation, higher fuel prices and higher prices for structural inefficiencies (such as electricity and water supply) remain upside risks to the inflation outlook, which we expect to increase from 4.2% in 2019 to 4.6% in 2020.