momentum investments

in the moment



Herman van Papendorp
Head of Investment Research & Asset Allocation

Sanisha Packirisamy
Economist

Roberta Noise
Economic Analyst

Inflation surprises moderately to the upside in August 2019

Highlights

- The Consumer Price Index (CPI) for August 2019 ticked up to 4.3% up from 4.0% in July 2019, slightly above the Iress consensus expectation of 4.2%.
- Core inflation also ticked up marginally to 4.3% in August 2019 from 4.2% in July 2019, signalling a gradual rise in underlying price pressures.
- The increase in headline CPI was attributable to housing and utilities, which added 1.3% (up 3.9%). It is likely that all the municipality electricity price increases have now been accounted for. Miscellaneous goods and services added 0.9% (increased by 5.8%) and food and non-alcoholic beverages added 0.7% (up 5.4%).
- Food prices rose on a normalisation of meat prices. A majority of the items in the food basket experienced an increase in inflation in the month.
- Services inflation remained unchanged at 4.7% between July 2019 and August 2019. Goods inflation, however, edged higher to 3.9% from 3.4% in July 2019, partly explained by higher food inflation.
- Although headline inflation ticked higher, inflation in 56% of the basket still fell within the 3% to 6% target range, which is higher than the 43% recorded in July 2019.
- While the currency and the international price of oil pose upside risks to the outlook for inflation, suppressed demand and a muted pass-through of the exchange rate should keep inflation well within the target range for the foreseeable future.

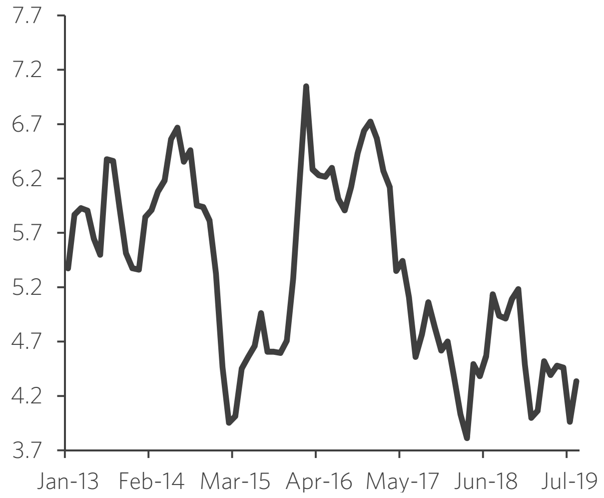
Headline inflation rises mildly above the consensus expectation

The CPI for August 2019 ticked up to 4.3% in year-on-year (y/y) terms from 4.0% y/y in July 2019 according to data released by Statistics South Africa (Stats SA) (see chart 1). The August 2019 print was slightly above the 4.2% Iress consensus expectation.

CPI increased by 0.3% in month-on-month (m/m) terms and was mainly driven by price movements in food and non-alcoholic beverages, alongside housing and utilities, which added 0.1%. Core CPI (which excludes volatile food and fuel prices) also ticked up to 4.3% y/y in August 2019 from 4.2% y/y in July 2019, signalling a gradual rise in underlying price pressures.

The increase in headline inflation was mainly attributable to housing and utilities, which added 1.3% to overall inflation and increased by 3.9% y/y. It is likely that all municipality electricity price increases have now been accounted for. Miscellaneous goods and services added 0.9% (up 5.8% y/y) and food and non-alcoholic beverages added 0.7% (increased by 5.4% y/y).

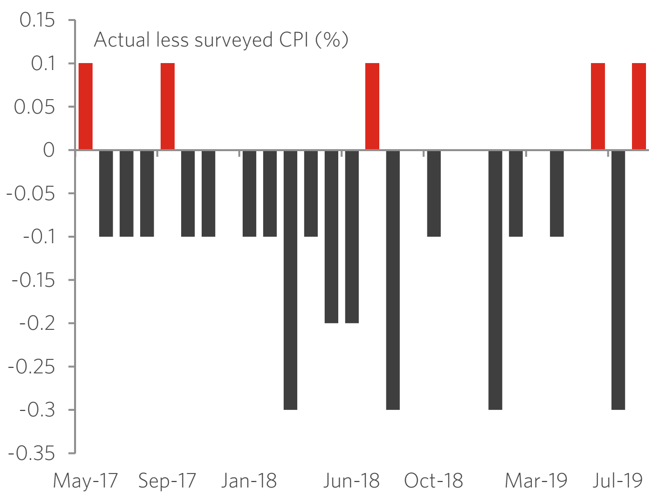
Chart 1: Headline inflation edges higher (% y/y)



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

Headline inflation surprised to the upside, as inflation pressure increased modestly in August 2019 (see chart 2). Electricity price increases have now been fully accounted for on a municipal level and are just below the 13% expectation. Food prices rose on a normalisation of meat prices. A majority of the items in the food basket experienced an increase in inflation in the month.

Chart 2: Significant downside surprise in inflation in July, followed by a marginal upside surprise in August

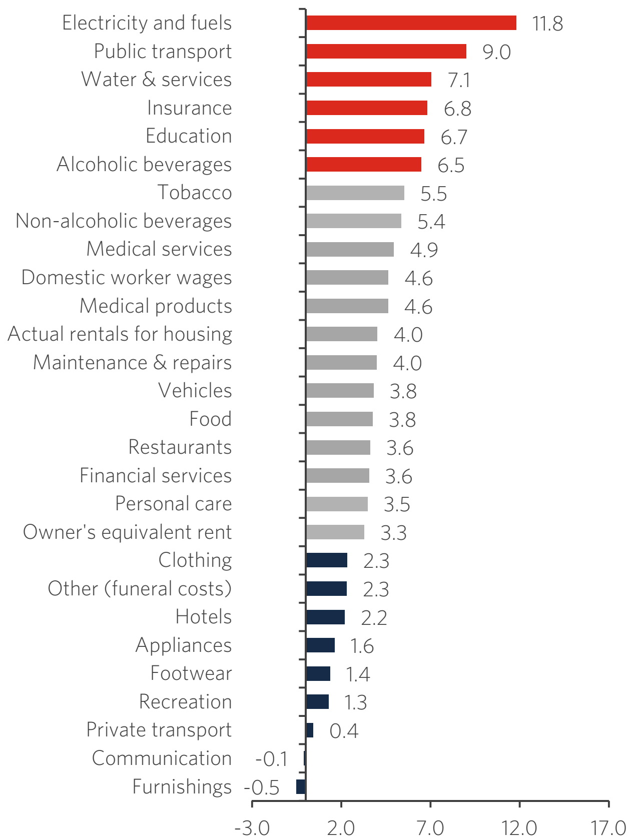


Source: Stats SA, Momentum Investments, data up to August 2019

Services inflation remained unchanged at 4.7% y/y between July 2019 and August 2019. Goods inflation, however, edged higher to 3.9% y/y from 3.4% y/y in July 2019, partly explained by higher food inflation. There was also a 0.4% rise in semi-durable inflation.

Although headline inflation ticked higher, inflation in 56% of the basket still fell within the 3% to 6% target range, which is higher than the 43% recorded in July 2019. More than 20% of the inflation basket registered above the upper 6% limit and more than 20% below the lower 3% limit of the range. Utility and transport prices remained above the 6% upper limit of the target, while food and rental inflation were slightly above the lower limit of the target (see chart 3).

Chart 3: Smaller proportion of basket printing above 6%

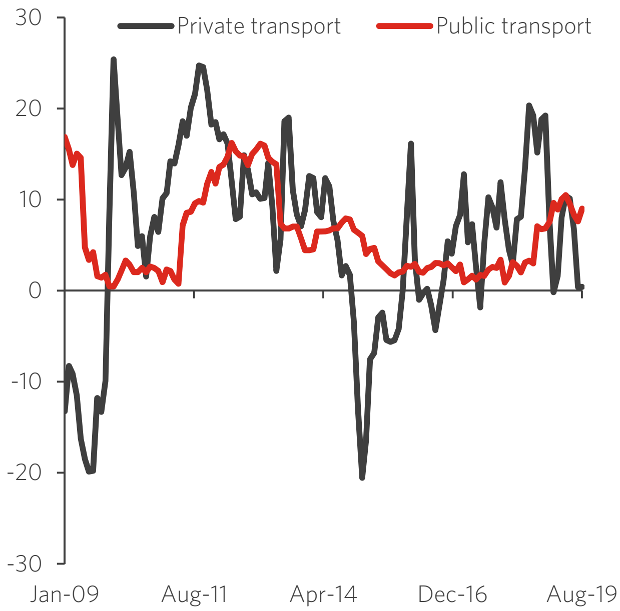


Source: Stats SA, Momentum Investments

Transport inflation remains at the lower limit, but public users feel the pinch

Transport inflation edged up mildly to 3.1% y/y in August 2019, from 3.0% y/y in July 2019 and added 0.5% to overall inflation. Private transport inflation only grew by 0.4% relative to a year ago from a low basis and slowed from the significant 7.4% y/y rate in June 2019. Public transport inflation reversed its 7.6% y/y decline in July 2019 and increased by a significant 9.0% y/y in August 2019 (see chart 4).

Chart 4: Elevated public transport inflation (% y/y)



Source: Stats SA, Momentum Investments

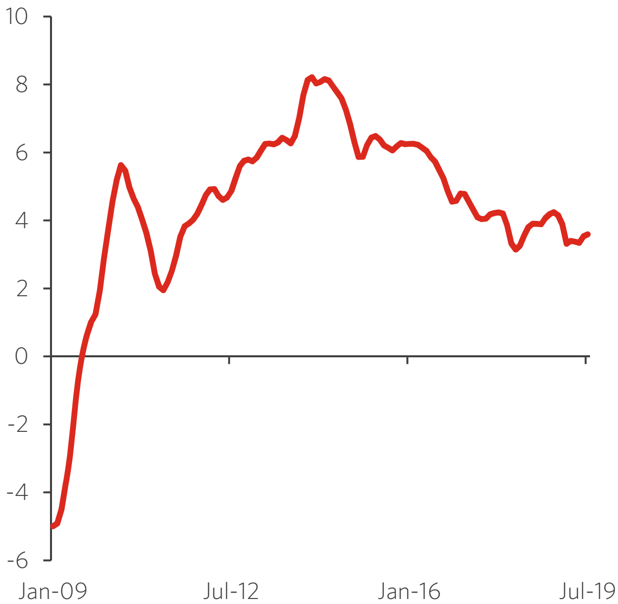
The price of petrol increased by 11 c/l in August 2019, after decreasing by a marked 96 c/l in July 2019.
Bloomberg mentioned that SA is one of the most vulnerable countries to oil price spikes, given the sell-off in the rand, as investors turn to save-heaven asset classes during periods of heightened geopolitical uncertainty. Saudi Arabia provides around 40% of oil imports to SA and the recent drone strikes have temporarily stalled Saudi's 5% contribution to global production. The price of Brent crude jumped by 20% following news of the attacks.
The combination of higher oil prices and a weaker rand could translate to higher domestic fuel prices in the short term.

The petrol price increased by another 11 c/l in September 2019. Further disruptions to global oil supply and the ongoing trade impasse could place additional pressure on domestic fuel prices in the near term.

Muted rental inflation continues to help keep headline inflation contained

Residential property prices and rental inflation are still rising at levels below current inflation. House prices remained unchanged at 3.6% y/y between July and August 2019.

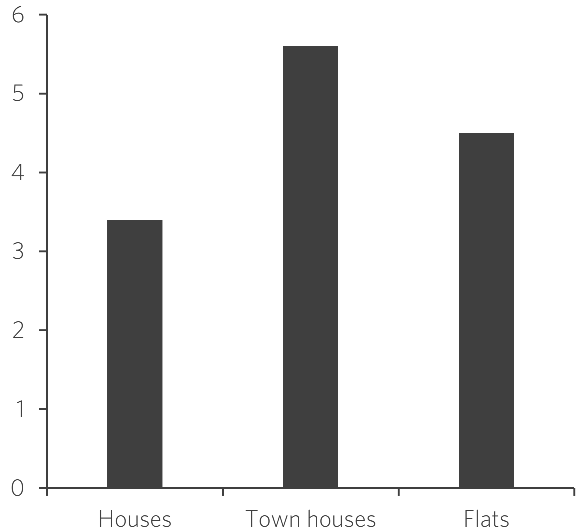
Chart 5: Muted rental inflation



Source: First National Bank Property Barometer, Stats SA, Momentum Investments

Rental inflation increased more significantly for townhouses in the second quarter of 2019, particularly in the more affluent areas. Free-standing houses also saw a mild uptick, while rent for flats declined marginally in the second quarter of 2019 (see chart 6).

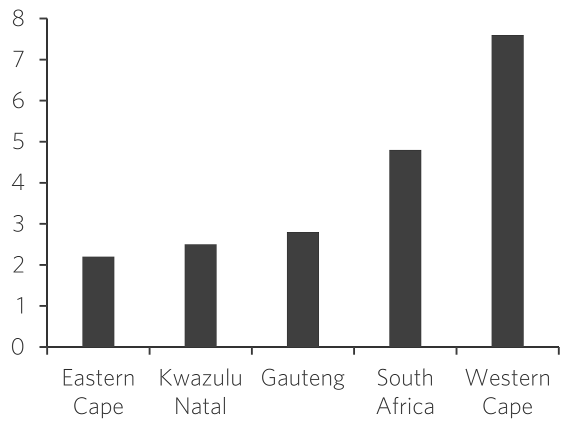
Chart 6: Rental inflation per housing category (% y/y)



Source: First National Bank Property barometer, Momentum Investments

The Western Cape reported the highest rental inflation in the second quarter of 2019, surpassing the total rate reported for the entire country (see chart 7). Lower rental inflation continues to keep a lid on headline inflation.

Chart 7: Western Cape rental inflation outstrips headline inflation and rental inflation for the country

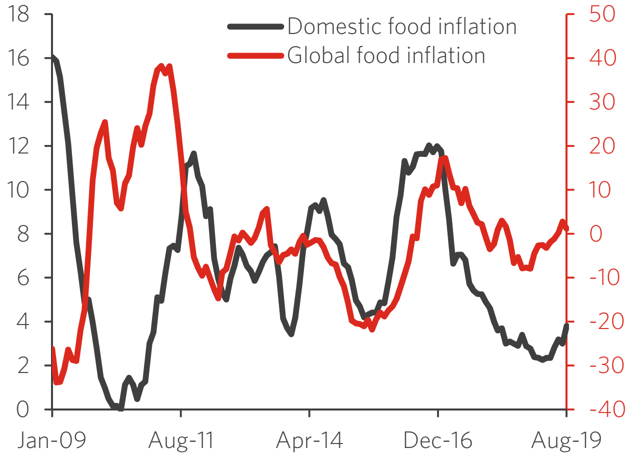


Source: First National Bank Property barometer, Momentum Investments

Broad-based rise in food inflation in August 2019

Food inflation rose to 3.8% y/y in August 2019 from 3.4% y/y in July 2019 (see chart 8). Global food inflation eased marginally to 1.1% y/y from 2.8% y/y in July 2019, according to the Food and Agriculture Organisation (FAO) (see chart 8).

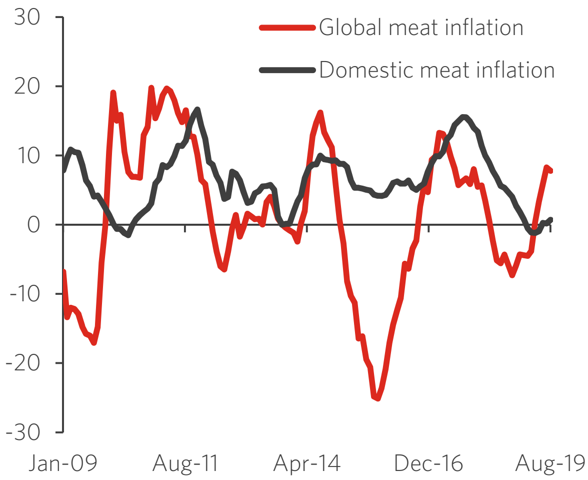
Chart 8: Global and domestic food inflation (% y/y)



Source: FAO, Stats SA, Momentum Investments

Inflation in global meat prices rolled over to 7.8% y/y in August 2019 from 8.3% in July 2019 according to the Food and Agriculture Organisation (FAO). The meat price index increased by 0.5% m/m, in line with the outbreak of African Swine Flu (ASF), intensified by the robust pork meat import demand from Asia, which inevitably raised the price of pork. Domestic meat prices increased by 0.7% y/y in August 2019 from 0.2% y/y in July 2019 (see chart 9), largely explained by higher prices in pork (5.9% y/y) and fresh and frozen chicken portions (2.5% y/y and 4.6 % y/y respectively). The price of beef and lamb declined by 0.5% y/y and 2.6% y/y respectively.

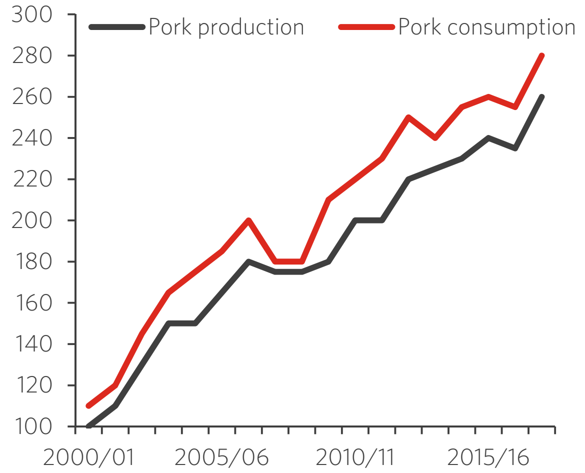
Chart 9: Global and domestic meat inflation (% y/y)



Source: FAO, Stats SA, Momentum Investments

There have been 14 reported cases of ASF domestically in the North West, Mpumalanga, Gauteng and the Free State, but mainly among smallholder farmers, therefore not reaching retail chains according to Agbiz. Although ASF is reported to not have an effect on humans, the premature culling of pigs might cause further shortages for consumption in SA because we are net importers of pork. Failure to limit the spread could result in further meat prices increases in the near term (see chart 10).

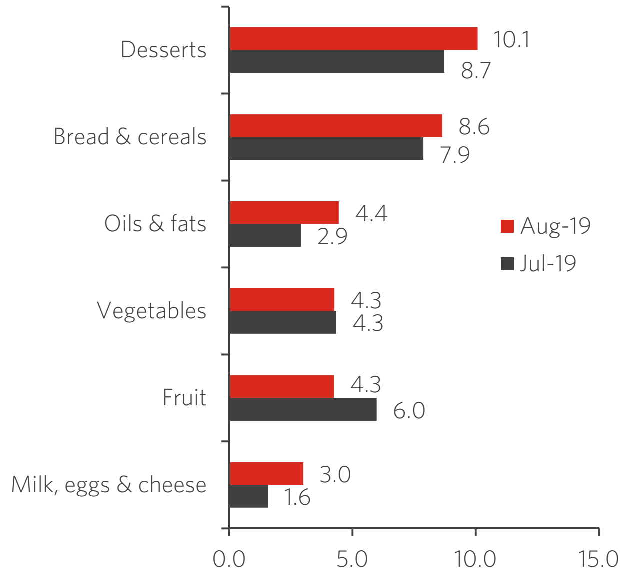
Chart 10: Domestic pork market (% y/y)



Source: DAFF, Momentum Investments

A significant portion of the food basket increased in August 2019 (see chart 11). The most significant increases were reported in oils and fat, desserts, milk and cheese.

Chart 11: Food inflation (% y/y)



Source: Stats SA, Momentum Investment

Modest rise in inflation likely not a cause for concern

The uptick in the August inflation print is largely explained by a rise in food and utility inflation, while fuel price increases contracted again from an elevated base a year ago. Fuel prices could experience some pressure in the near term, given the continuation of global uncertainty still at play, coupled with supply-side disruptions in the global oil market.

In our view, the depreciation in the exchange rate since the July interest-rate-setting meeting (from R/$14.01 to R/$14.69) and the uptick in the international price of oil (from US$62.46 to US$63.67) could prevent the SA Reserve Bank (Sarb) from cutting interest rates again at the 19 September 2019 Monetary Policy Committee (MPC) interest-rate-decision meeting, given the upside risks these factors pose to inflation. Nevertheless, we still believe there is room to reduce interest rates further in light of the inflation trajectory expected to remain with target for the foreseeable future and inflation expectations remaining contained. With other emerging market central banks also embarking on further interest rate cuts, a 25-basis point reduction in SA's repo rate would still leave the country's real interest rate at a relatively attractive level. Moreover, while a lower interest rate policy is not the panacea for growth, it could incite marginally higher levels of confidence.