momentum investments

in the moment

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Inflation surprises further below the midpoint in October 2019

Highlights

- The Consumer Price Index (CPI) for October 2019 surprised below the consensus expectation of 3.9% and fell to 3.7%.
- The most significant contributors to the October number included housing and utilities (1.2%), miscellaneous goods (0.9%) as well as food and non-alcoholic beverages (0.6%).
- There was a broad-based contraction in goods inflation, while administered price inflation slowed to a low of 3.5% in October 2019 from 5.2% previously. Meanwhile, core inflation remained unchanged at 4.0%.
- Transport inflation slowed to 0.3% in October 2019 from 2.4% in September 2019, which is the lowest level seen since July 2017, because of a cut in the petrol price.
- Food inflation dipped surprisingly to 3.5% from 3.7% in September 2019 because of lower inflation in the majority of food sub-divisions, except prices for fish, milk, eggs and fruit.
- The late, but heavy, rains alleviated dry soil conditions, but after January 2020, below-average rainfall is expected across all regions in South Africa (SA). This could put upward pressure on food prices, but muted consumer demand could lower retailer pass through to the end consumer.

Headline inflation dips to the lowest level since February 2011

Statistics (Stats) SA released the CPI number for October 2019 and the number surprised below the consensus expectation of 3.9% in year-on-year (y/y) terms to 3.7% (y/y). This was the lowest the index has fallen to since February 2011 (see chart 1). The index fell from 4.1% y/y in September 2019 but did not change in month-on-month (m/m) terms in October 2019.

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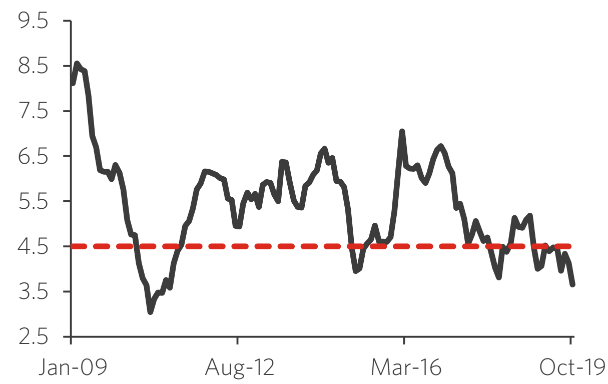
Chart 1: Inflation surprises to the downside



Source: Stats SA, Momentum Investments

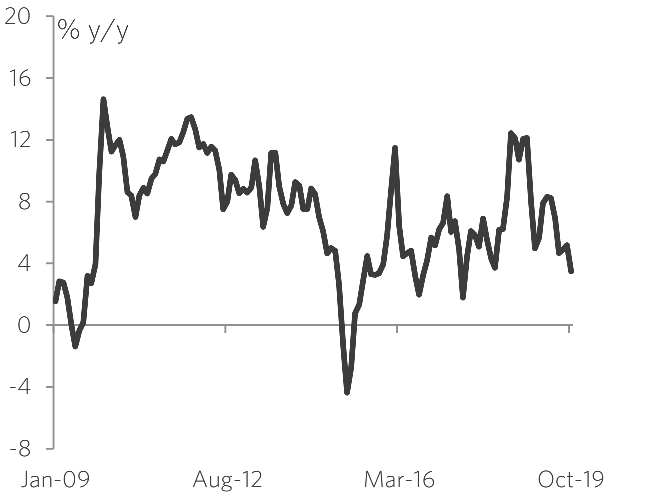
Housing utilities and miscellaneous goods remained unchanged at 4.7% y/y and 5.7% y/y respectively between September and October 2019. Food and beverages slowed to 3.6% y/y from 3.9% y/y.

Services inflation remained unchanged at 4.2% y/y between September 2019 and October 2019, while goods inflation subsided significantly to 3.1% y/y from 4.0% y/y in September 2019. There was a broad-based alleviation in goods inflation, with prices of non-durable goods (mostly food and fuel) declining by 3.5% y/y in October 2019 from 4.5% y/y in September 2019. Durable goods (furniture and appliances) inflation slowed to 2.2% y/y in October 2019 from 2.4% y/y, alongside semi-durable goods inflation (clothing and footwear) which slowed to 2.0% y/y from 2.1% y/y.

Administered prices slowed to a low of 3.5% y/y in October 2019 from 5.2% y/y, which was the lowest level so far for 2019 (see chart 2). A significant detraction from the fuel component can explain the decline. Fuel removed 1.6% from the October 2019 number, previously flat in the September 2019 print. Water supply contributed 0.7% in October 2019, which is less than 0.8% in September 2019.

Core or underlying inflation remained unchanged at 4.0% y/y between September 2019 and October 2019.

Chart 2: Administered price inflation subdued for now



Source: Stats SA, Momentum Investments

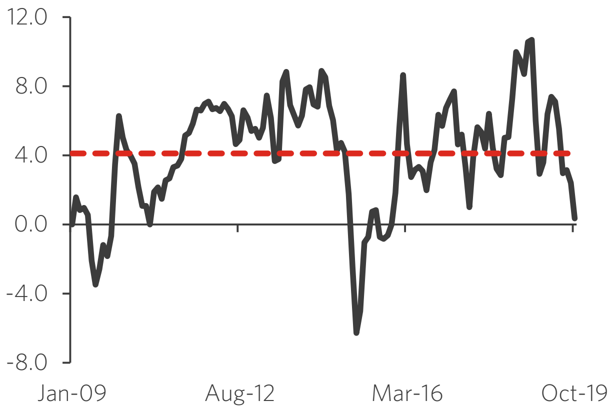
Downside risks to inflation persist in the absence of demand-pull inflation. Inflation is likely to remain below the midpoint of the target range for the remainder of 2019 and average below 5% in 2020, in our view.

Petrol prices drive transport inflation lower

Transport inflation slowed to 0.3% y/y in October 2019 from 2.4% y/y in September 2019, a level which was last seen in July 2017 (see chart 3). The index, however, rose by 0.5% m/m. Transport inflation added 0.1% to the October number, previously adding 0.4% in September 2019.

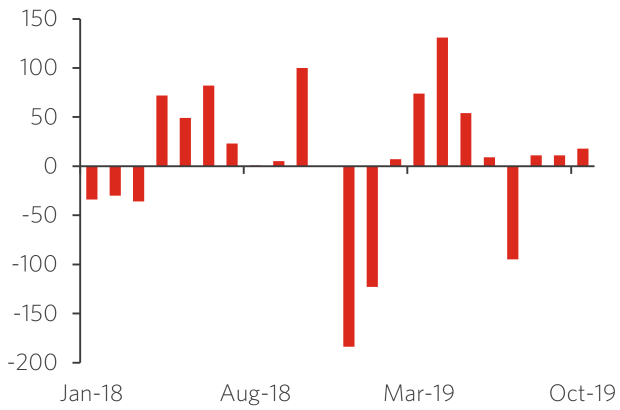
Public transport inflation declined by 2.5% y/y in October 2019 from 3.0% y/y in September 2019, which is the lowest level in 16 months. Private transport inflation contracted meaningfully by 3.2% y/y from 1.1% y/y in October 2019.

Chart 3: Transport inflation below average (% y/y)



Source: Stats SA, Momentum Investments

Chart 4: Petrol price change (95 octane c/l)

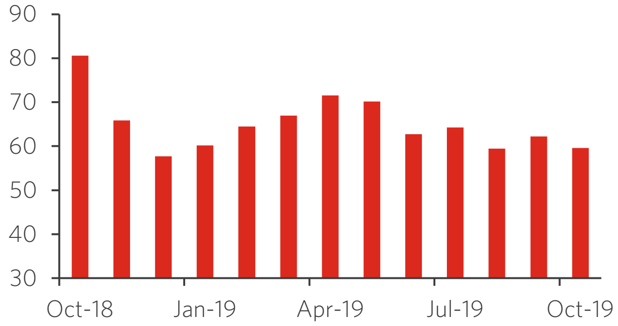


Source: Iress, Momentum Investments

The change in the petrol price can explain the decline in transport inflation. The petrol price rose significantly by R1.00 c/l in October 2018 relative to R0.18 c/l in October 2019 (see chart 4). This reprieve is as a direct result of a lower oil price in October 2019 at US$59.62/bbl from a high of US$80.58/bbl reported in October 2018 (see chart 5).

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

Chart 5: Lower oil price trend

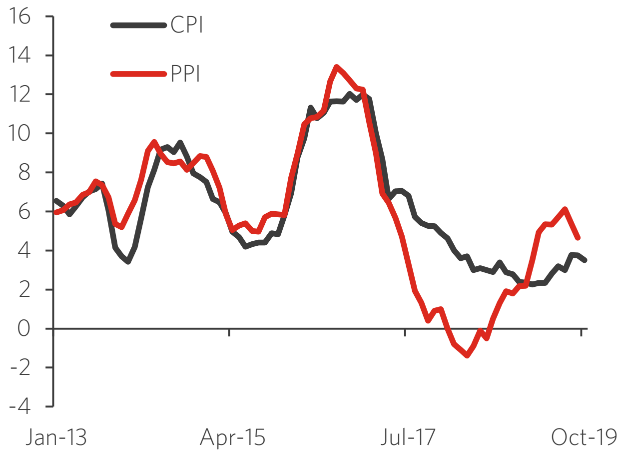


Source: Iress, Momentum Investments

Below-average and delayed rainfall could push food inflation higher

Food inflation reduced to 3.5% y/y from 3.7% y/y in September 2019. Lower inflation was visible in all of the food sub-divisions except for prices for fish, milk, eggs and fruit. Consumer food inflation has been lower relative to producer food inflation since the start of 2019, given weaker consumer demand (see chart 6).

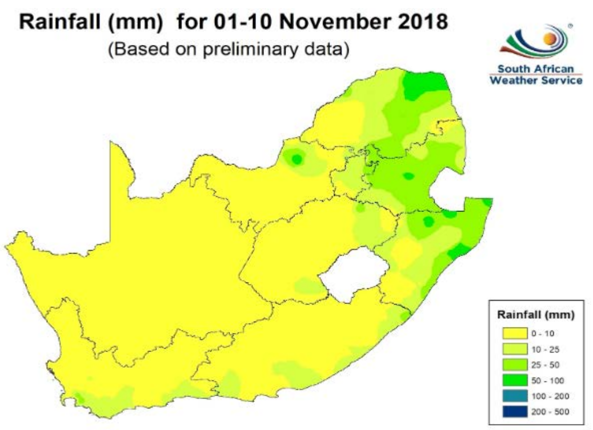
Chart 6: Food inflation still trending lower (% y/y)



Source: Stats SA, Momentum Investments

Rainfall for the first 10 days of November 2018, in millimetres (mm), was lower than what was recorded in the pre-drought years (see chart 7).

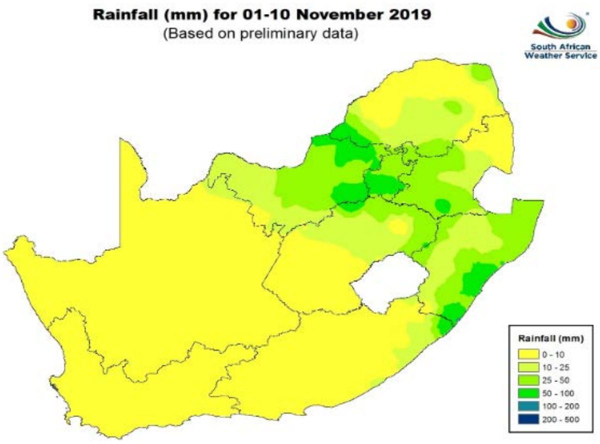
Chart 7: Rainfall (in mm) was lower in the first 10 days in November 2018



Source: SA Weather Service, Momentum Investments

The first 10 days in November 2019, however, have seen heavier rainfall in the eastern parts of Mpumalanga and the Kwazulu-Natal area, resulting in flooding and damage (see chart 8). These late rains have nonetheless arrived after the optimal maize planting window, which runs from 15 October 2019 to 15 November 2019 according to the Agricultural Business Chamber (Agbiz). The risk of frost damaging the yields of crops that are planted after this period is high.

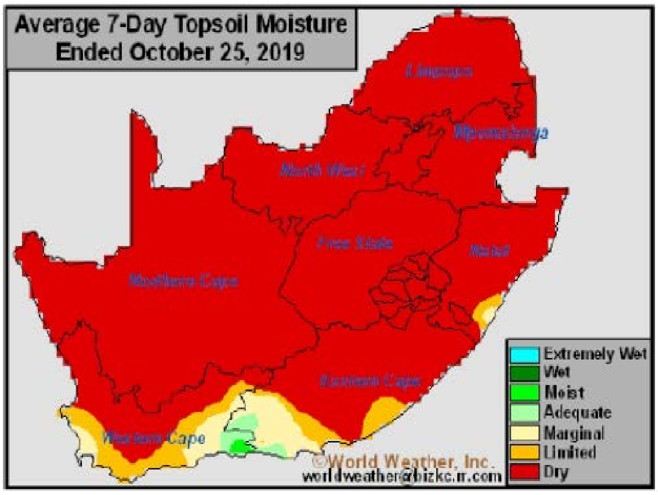
Chart 8: Rainfall (in mm) was heavier in the first 10 days in November 2019



Source: Sarb, Momentum Investments

The late rains have affected the soil moisture, which was significantly dry well up until the second-last week of October 2019 (see chart 9). The majority of all regions in SA, which receive rainfall in the summer, is forecasted to get rainfall of up to 60mm in the second-last week of November 2019, according to the expected weekly rainfall forecast from George Mason University. The Eastern Cape is nevertheless excluded from the rainfall expectation.

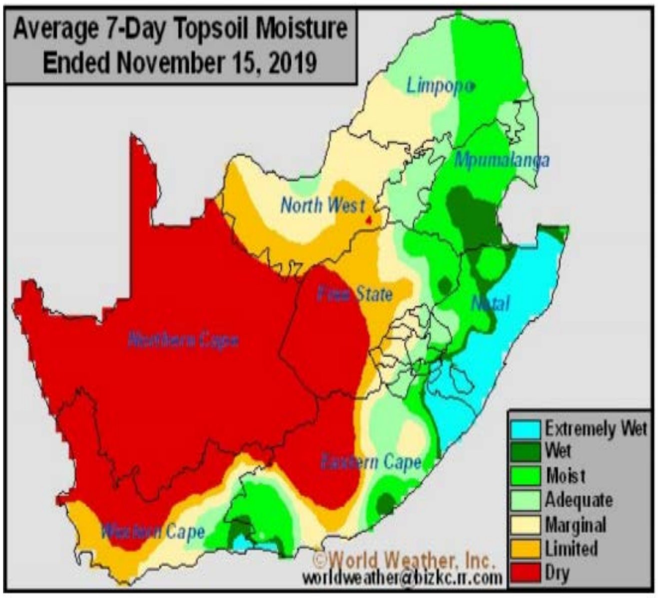
Chart 9: Soil moisture still dry at 25 October 2019



Source: Sarb, Momentum Investments

The first bout of rain was heavy and alleviated a significant portion of the dryness of the topsoil in the early days of November 2019 (see chart 10). However, below-average rainfall is expected after the end of January 2020 across all regions. This will likely result in higher food inflation in 2020 according to Agbiz. In the September 2019 Monetary Policy Review, the Sarb indicated that it expects food inflation to peak at 6% in the third quarter of 2020.

Chart 10: Soil moisture improved at 15 November 2019



Source: Sarb, Momentum Investments

Meat inflation remained unchanged at 1.1% y/y between September and October 2019, but increased by a tepid 0.2% m/m. Meat inflation is likely to slow again in the near term after a moderate normalisation, following the lifting of the ban on meat exports, once SA was declared free of foot-and-mouth disease (FMD). A renewed outbreak of FMD reported in the Molemole area in Limpopo could have a near-term effect on meat prices. Hoofed animals (goats, sheep and pigs) from SA are now banned in Zimbabwe and Mozambique.

There was a 5.2% y/y rise in the price of fresh chicken portions in October 2019 from 3.4% y/y in September 2019. The price for frozen chicken pieces also increased in October 2019 to 1.9% y/y from 1.5% y/y in September 2019.

Astral, one of the most significant suppliers in the poultry industry, continues to face water supply challenges. The company is sourcing water directly from the Vaal River using its filtration plant, amounting to R2 million a month. Higher feed costs for the chickens have been a consequence of the drought. Poultry prices could, therefore, rise in the near term.

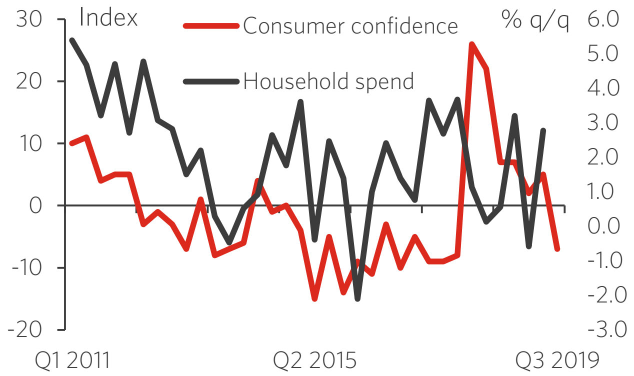
Inflation in bread and cereals between September 2019 and October 2019 remained unchanged at 8.5% y/y.

However, elevated prices in bread and cereals remain a risk due to rainfall expectations.

Muted demand-pull inflation underpinned by struggling consumers

The consumer has been hit with bouts of utility price increases, amid a low growth environment. A reversal of consumer confidence back into negative territory and an already lacklustre household spend trajectory does not indicate that demand-pull inflation will likely be an inflation pressure point in the near term (see chart 11).

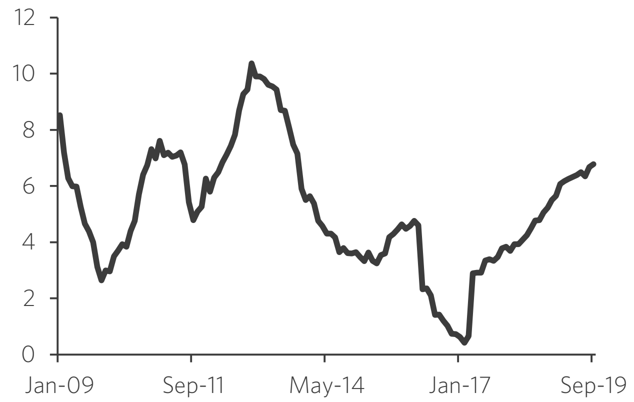
Chart 11: Confidence slumping into negative territory



Source: BER, Stats SA, Momentum Investments

Household credit growth has been steady in recent months but has likely been a function of servicing existing credit and not directed towards new semi-durable and durable expenditure (see chart 12).

Chart 12: Household credit growth (% y/y)



Source: Sarb, Momentum Investments

Although continued downside inflation surprises and muted inflation expectations argue for a cut in interest rates, the upcoming November 2019 monetary policy decision is likely to be a close one given significant fiscal slippage in the October 2019 Medium-term Budget Policy Statement (MTBPS).

Below-average and delayed rainfall has a high likelihood of rising inflation in the near term, but muted consumer demand will likely cap retailer pass through to the consumer level. Given tepid consumer demand and subdued currency pass through, we do not expect inflation to breach the upper limit of the target range in the medium term.