momentum investments

in the moment

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Lower-than-expected electricity and water tariffs drive inflation to the bottom half of target in July 2019

Highlights

- Consumer price inflation (CPI) for July 2019 eased to 4.0% from 4.5% in June and came in lower than Bloomberg's expectation of 4.3%.
- Easing inflation in July was underpinned by a significant drop in transport prices, explained by a petrol price cut of 96 c/l.
- The largest contributors to headline inflation were housing and utilities (which rose 5.1% and added 1.2% to the print), followed by miscellaneous goods (which grew by 5.4% and added 0.9%). The last significant contributor was food and non-alcoholic beverages inflation, which grew by 3.4% and added 0.6%.
- Inflation in 18% of the CPI basket was above the upper limit of the inflation target of 6%. This proportion declined from 26% in June 2019.
- Inflation in administered prices was also realised closer to the midpoint. Administered price inflation dipped to 4.7% from 6.9% in June 2019 and was lower than the 12.4% number in July 2018.
- Downside inflation surprises emanated from food and non-alcoholic beverages, rentals, water tariffs, electricity tariffs, public transport, hotels and other services (comprising mostly of funeral costs).
- Food inflation eased to 3.0% in July 2019 from 3.2% in June 2019.
- Although interest rates cuts in the local economy were expected to have a limited effect on growth, it could boost sentiment at the margin. Moreover, consistent downside surprises in inflation prints should allow for a further interest rate cut in the coming months.

CPI surprises below consensus

Statistics South Africa (Stats SA) released the CPI for July 2019 and the print declined more significantly than anticipated. CPI for July 2019 eased to 4.0% in year-on-year (y/y) terms from 4.5% y/y in June and came in lower than the Bloomberg expectation of 4.3% (see chart 1). Easing inflation in July 2019 was underpinned by a significant drop in transport prices, explained by a petrol price cut of 96 c/l. Although electricity tariffs were implemented in July 2019, not all municipalities have applied the increase as yet and there could be further rises in the coming months to capture the outstanding municipal increases.

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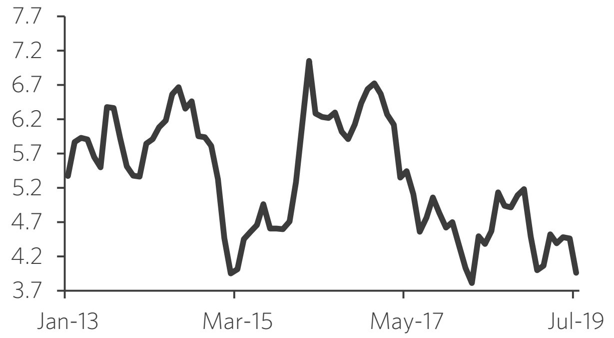
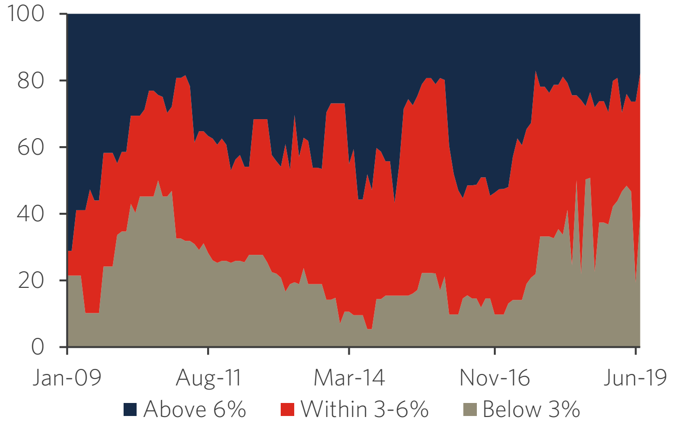
Chart 1: Headline inflation dips below midpoint of the target range (% y/y)



Source: Stats SA, Momentum Investments

In July, variables with significant weight in the CPI basket were surveyed. These included electricity and other fuels carrying the largest weight (3.2%), followed by water and other services (3.8%). In month-on-month (m/m) terms CPI rose by 0.4% in July 2019, driven by housing and utilities which grew by 2.4% m/m and added 0.6%. Transport declined by 1.5% and subtracted 1.2%.
Core inflation slowed to 4.2% from 4.3% in June 2019 and the trimmed mean (the exclusion of the top and bottom 10% and calculating the arithmetic mean of the 80%) declined to 4.4% from 4.6%.

Chart 2: Smaller proportion of basket printing above 6%

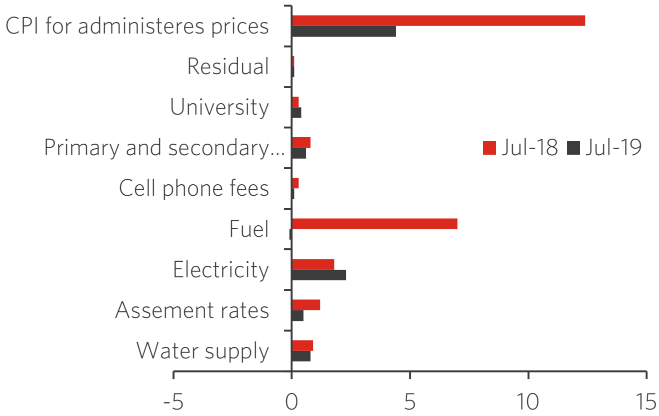


Source: Stats SA, Momentum Investments, data up to July 2019

In July 2019, 39% of the CPI basket printed below the lower 3% band, up from 19% in June 2019. Similarly, 42% of the basket recorded in the 3% to 6% target range, down from 55% and 18% of the CPI basket printed above the upper 6% band, down from 26% in June 2019.
Headline inflation remains well contained within the target range, with a growing portion of the basket now below the lower 3% band (see chart 2).

Inflation in administered prices was also realised closer to the midpoint. Administered price inflation registered at 4.7%, down from 6.9% in June 2019 and lower than the 12.4% print in July 2018. Fuel subtracted 0.1%, while electricity added 2.3% in July 2019 (see chart 3).

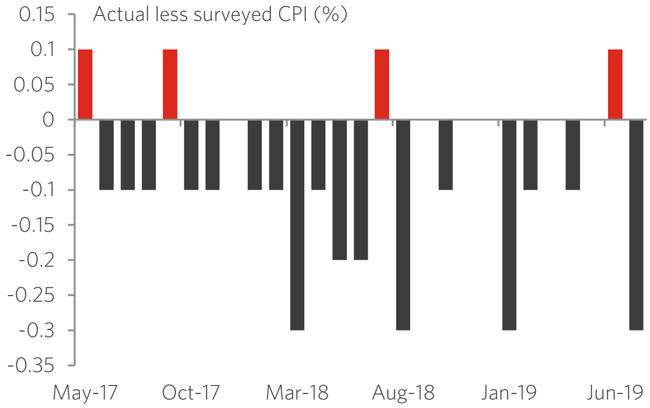
Chart 3: Administered prices trend lower



Source: Stats SA, Momentum Investments

Downside inflation surprised significantly in July 2019, despite a number of administered prices being surveyed (see chart 4). This emanated from food and non-alcoholic beverages (3.4% y/y), rentals (4.0% y/y), water tariffs (7.1% y/y), electricity (10.4% y/y), public transport (7.6% y/y), hotels (1.3% y/y), and other services (funeral costs) (2.3% y/y).

Chart 4: Inflation downside surprise higher



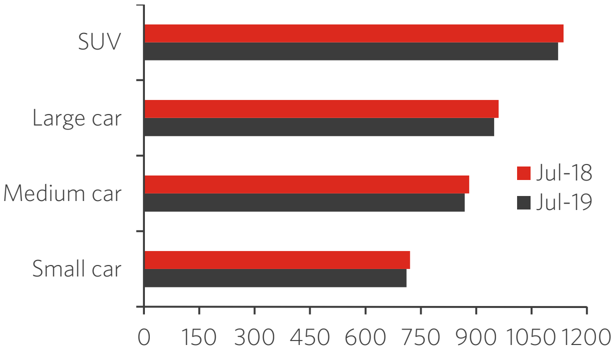
Source: Stats SA, Momentum Investments, data up to July 2019

Transport inflation eases significantly

Transport inflation grew by a softer 3.0% in July 2019, down from 5.5% in June 2019 and contributed 0.4% to the July inflation print. Fuel inflation contracted to negative 0.5% in July 2019 from 7.4% in June 2019 and could be explained by the petrol price cut of 96 c/l in July.
Public transport inflation declined to 7.6% in July from 8.3% in June 2019, while private transport inflation declined to 0.4% from 6.7% in the same period.

The price of petrol increased by 12.9% year to date, higher than 11.10% for the same period a year ago, underpinned by deteriorating geopolitical relations. The price of a full tank, however, eased by 1.3% y/y between July 2018 and July 2019 (see chart 5).

Chart 5: Price of a full tank for different car sizes (% y/y)



Source: Avis car sizes, Iress, Momentum Investments

The Organisation of Petroleum Exporting Countries (Opec) cut its forecast for demand for global oil by 40 000 barrels per day to 1.1 million in its recent monthly report.
The likelihood of this pattern continuing remains high and is largely attributable to the trade dispute and no-deal Brexit possibilities that remain heightened and are dampening global growth. A surplus has been pencilled in for 2020. The report indicated an oversupply of 200 000 barrels of oil, smaller than 500 000 barrels reported previously.

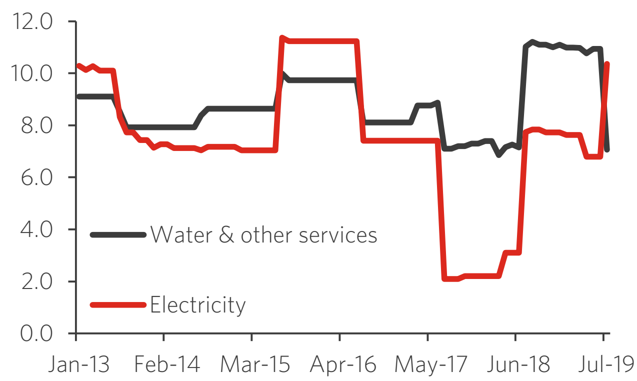
The price of Brent crude has deteriorated by nearly 4% year to date and contracted by 8.7% between July 2019 and 19 August 2019. The Central Energy Fund is currently however forecasting a 9 c/l under recovery between 2 August 2019 and 20 August 2019, largely explained by the weaker rand. This follows the 11 c/l increase in petrol for August 2019. Both these increases will be reflected in a rise in transport inflation in August and September.

Electricity and water tariffs rise by less than anticipated

The City of Johannesburg and the City of Tshwane followed the City of Cape Town's lead in introducing a fixed monthly charge for prepaid customers. The City of Johannesburg however reversed its surcharges and the National Energy Regulator of South Africa (Nersa) rejected the City of Tshwane's tariff application. Nevertheless, consumers still experienced a rise in electricity charges attributable to the 13.8% annual tariff increase announced in March 2019. Consumers who buy electricity from municipalities experienced a 10.4% y/y increase in July 2019, lower than the above 13% consensus expectation (see chart 6).

The City of Tshwane's new tariff was not included and will be implemented from September 2019 according to Absa research. Water costs increased 10.3% m/m and 7.1% y/y in July 2019.

Chart 6: Utilities surprise to the downside

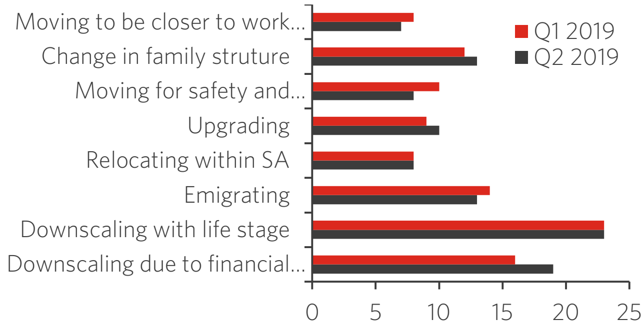


Source: Stats SA, Momentum Investment

Rental inflation remains stagnant in a moribund consumer environment

Residential property prices edged slightly higher to 3.6% in July 2019 from 3.5% but was still below rental inflation (3.3% unchanged between June 2019 and July 2019) and headline inflation. Although the CPI has been trending lower and moving closer to the midpoint, the second highest reason for consumers selling residential property is downscaling due to financial pressure (see chart 7). This indicates that the increase in purchasing power through lower inflation has not alleviated high utility costs and tax burdens for the middle to high-income consumer.

Chart 7: Reasons for selling property

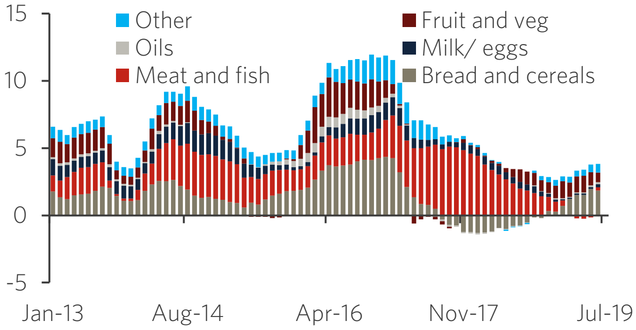


Source: First National Bank Property barometer, Momentum Investments

Another downside surprise in food inflation

Food inflation eased to 3.0% y/y in July 2019 from 3.2% y/y in June 2019 (see chart 8). Bread and cereals edged higher to 7.9% y/y from 7.3% y/y, alongside fish (up to 6.4% y/y from 6.0% y/y), fruit (up 6.0% y/y from 4.5% y/y) and desserts (up to 8.7% from 8.2% y/y). This was however offset by meat inflation easing to 0.2% from 0.3% in the same period, alongside milk and eggs (down to 1.6% y/y from 2.1% y/y), oils and fats (down to 2.9% y/y from 3.5% y/y) and vegetable prices which eased to 4.3% y/y from 5.7% y/y.

Chart 8: Food inflation (% y/y)



Source: Stats SA, Momentum Investments

SA is likely to remain a maize exporter in 2019/2020 according to the Agricultural Business Chamber (Agbiz), granted domestic production amounts to 10.9 million tonnes this year. 2019/2020 is likely to see SA remain a net wheat importer, albeit 36% lower than in the previous year. The Agricultural Business Chamber (Agbiz) stated imports amounted to 68% year to date. Key suppliers include Germany, Russia, Lithuania and Canada.

Unfavourable weather conditions in Zimbabwe reflect the poor maize harvest, which is down 53% from a year ago, according to Agbiz. However, fears of SA exporting maize to the country has partially abated given that there has been no official data regarding maize imports into Zimbabwe as of May 2019. SA could still be a source of white maize for the country since the World Food Programme (WFP) indicated extended support to Zimbabwe until April 2020.

Continued downside surprises in inflation could lead to another interest rate cut

Emerging market central banks have continued to slash interest rates in response to elevated uncertainty and continued downside risks to the outlook for global growth. Central banks in Thailand (25 basis points to 1.5%), Mexico (25 basis points to 8%), India (35 basis points to 5.4%) and the Philippines (25 basis points to 4.25%) cut interest rates in August 2019, following on from cuts in the interest rate in Brazil (50 basis points to 6%), Russia (25 basis points to 7.25%), Turkey (4.25% to 19.75%) and Indonesia (25 basis points to 5.75%) in July 2019.

Although cutting interest rates in the local economy are expected to have a limited effect on growth, it could boost sentiment at the margin. Moreover, consistent downside surprises in inflation prints and an encouraging downward trend in inflation expectations, closer to the midpoint of the 3% to 6% inflation target band, should allow for a further interest rate cut by the SA Reserve Bank in the coming months. A more aggressive response in interest rates, however, remains stymied by too loose fiscal policy pointing to a shallow interest rate cutting cycle this time around.