momentum
investments

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in the moment

Marginal uptick in headline inflation to 4.8% y/y in August

Highlights

- The Consumer Price Index (CPI), published by Statistics South Africa (Stats SA), ticked up to 4.8% year-on-year (y/y) in August 2023, following four consecutive decreases that led to inflation falling to 4.7% y/y in July.
- The headline inflation outcome was on par with the Reuters median consensus while core inflation rose by slightly more than anticipated (4.8% y/y against the expectation of 4.7% y/y).
- The biggest driver behind the increase in CPI was the rate of transport deflation moderating to negative 0.8% y/y in August from negative 2.6% y/y in July, reflecting the diminishing high base effects of fuel inflation.
- The continuation of subsiding base effects, the large fuel hike in September (R1.71/l for both grades of petrol and R2.84/l for diesel (0.05%)) and forecasts of higher international oil prices will likely place further upside pressure on transport inflation, leading to an acceleration in headline inflation, in the very near term.
- Data from the Central Energy Fund (CEF) suggests that large fuel hikes can be expected in October. The estimated under-recovery on 18 September was recorded at R1.24/l for petrol (95) and R1.97/l for diesel (0.05%).
- The price of Brent crude oil increased to an average of US$86.2/bbl in August and breached the US$90/bbl level on 5 September 2023. The United States (US) Energy Information Administration (EIA) estimates Brent crude oil to average US$92/bbl in September, increase to US$93/bbl in October and November and moderate to below US$90/bbl from April 2024.
- Food inflation softened to single digits (8.2% y/y) in August, the lowest number since June 2022. The South African Reserve Bank (SARB) expects food inflation to decelerate for at least another six months on the back of good crops and cattle restocking.
- Risks to food inflation are relatively muted (including, slightly lower levels of cattle slaughtering in the first seven months of 2023 relative to a year ago and the reintroduction of poultry tariffs). On a positive note, the nominal United Nations (UN) Food and Agriculture Organisation (FAO) Food Price Index dropped by 2.1% month-on-month (m/m) in August 2023, reversing the 1.1% m/m increase in July; local farmers are increasingly investing in alternative sources of energy which will benefit production and there are efforts underway to revive the Black Sea Grain Initiative which expired in July 2023.
- Households in expenditure deciles one to three (annual expenditure of less than R48 673) are expected to benefit from the continued deceleration in food inflation while the large fuel hikes place upward pressure on households in the upper deciles (annual expenditure of more than R143 175).
- Considering inflation remained well within the target range in August, we maintain our view of another repo rate pause at the upcoming September 2023 interest-rate setting meeting, but the tone will likely be hawkish to reflect

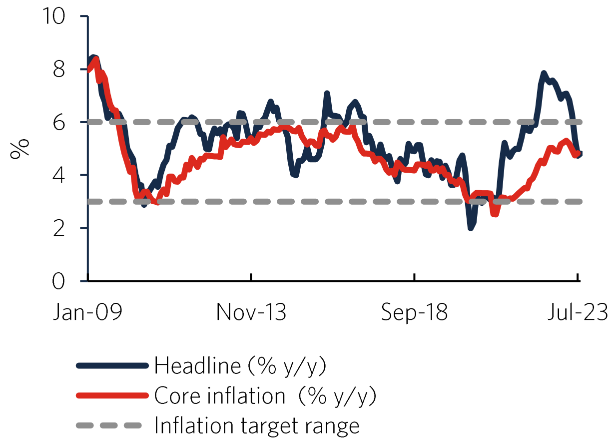
upward pressure on transport inflation, concerns over the volatility of the currency, higher administered prices, loadshedding and the risk of El Niño.

- We expect the SARB to maintain a restrictive stance on monetary policy in light of fiscal dominance fears and persistent upside risks to the inflation profile. As such, we only expect the first cut in interest rates in the second quarter of 2024.

No major inflation surprises for August

Following four consecutive months of softer headline inflation prints, Stats SA reported a slight rebound of 4.8% y/y in August from 4.7% y/y in July. Food and non-alcoholic beverages (NAB), housing and utilities as well as miscellaneous goods and services continued to contribute the most to the headline rate. However, the uptick to 4.8% y/y was driven by the rate of transport deflation moderating from negative 2.6% y/y in July to negative 0.8% y/y in August and housing and utilities inflation accelerating from 5.1% y/y to 5.5% y/y over the same period. Core inflation also ticked higher to 4.8% y/y in August from 4.7% y/y in July. Both headline and core outcomes were broadly in line with the Reuters median consensus of 4.8% y/y and 4.7% y/y, respectively and remained within the SARB's 3% to 6% inflation target range (see chart 1).

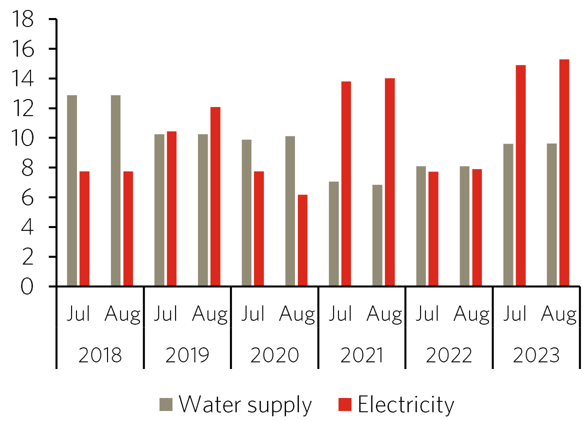
Chart 1: Uptick in inflation does not compromise the target range



Source: Global Insight, Stats SA, Momentum Investments
Data until August 2023

August is one of the lower survey months as only an additional 7.16% of the basket is surveyed outside of the monthly surveyed items. The additional items surveyed in August include private sector hospitals; rugby, cricket and soccer tickets; as well as municipal charges for water, property taxes and electricity. Electricity and water costs was surveyed in July and while electricity inflation shot up to 15.3% y/y in August and water inflation rose by 9.6% y/y (see chart 2), the month-on-month changes incorporating municipalities not surveyed in July was broadly unchanged at 0.7% m/m for electricity and constant for water supply.

Chart 2: Electricity inflation shoots up to 15.3% y/y



Source: Global Insight, Stats SA, Momentum Investments

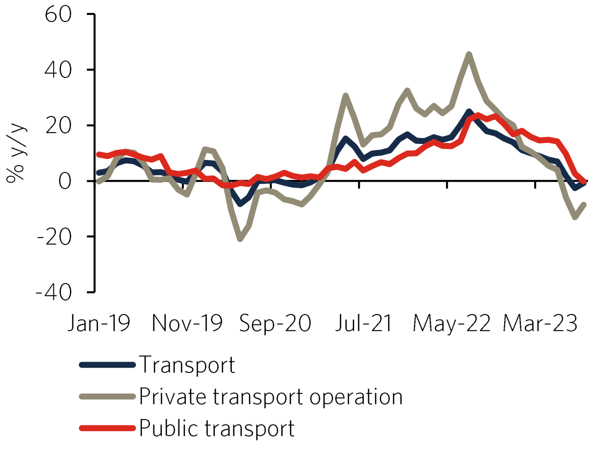
Restaurants and hotels recorded a sharp rise in inflation from 5.2% y/y in July to 6.4% y/y in August as demand continues to recover in the sector.

Transport inflation expected to edge higher in the coming months

Higher international oil prices and the weaker exchange rate are placing upward pressure on domestic transport inflation.

In July 2023, the price of Brent crude oil averaged US$80.1/bbl, up from an 18-month low of US$74.8/bbl in June. Higher international oil prices were partly offset by the slightly stronger exchange rate of R18.18 against the dollar (July average) compared to an average of R18.72 in June. Consequently, both grades of petrol increased marginally by 37 c/l and diesel (0.05%) increased by 72 c/l in August. Fuel price increases contributed to the sharp moderation in the rate of private transport (mostly fuel) deflation from negative 13.1% y/y in July 2023 to negative 8.6% y/y in August (see chart 3). However, this moderation mostly reflects base effects wearing off from the peak of 45.5% in July 2022. On the other hand, public transport slipped into deflation at negative 0.2% y/y in August from 2.6% y/y in July.

Chart 3: Private transport deflation moderates sharply

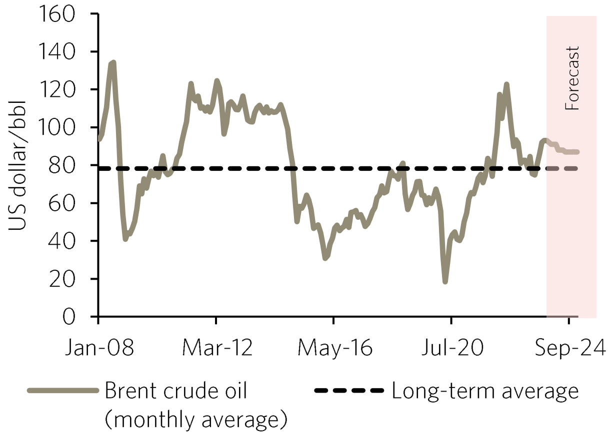


Source: Global Insight, Stats SA, Momentum Investments

The price of Brent crude oil increased to an average of US$86.2/bbl in August and breached US$90/bbl on 5 September 2023. The EIA estimates Brent crude oil to average US$92/bbl in September, increase to US$93/bbl in October and November and moderate to below US$90/bbl from April 2024 (see chart 4). The expected higher oil price in the coming months is based on an anticipated decline in global oil inventories on the back of production cuts from Saudi Arabia and Russia. An increase in inventories is expected from the second quarter of 2024, reflecting "slowing oil demand growth, non-OPEC (Organization of the Petroleum Exporting Countries) oil production growth, and the end of Saudi Arabia's voluntary production cuts". However, the EIA notes that there is a risk of an extension in voluntary production cuts.

Higher international oil prices are reported to increase inflationary pressures in the US. According to the *Business Insider*, the US has been using its strategic petroleum reserves (SPR) to contain energy prices since the onset of the Russia-Ukraine war. While the US government notes that this strategy helped to lower fuel prices, reserves have since dropped to a 40-year low. "Low reserves could increase the risk of the US being reliant on imports, potentially making it more vulnerable to supply disruptions and price volatility in the global oil market".

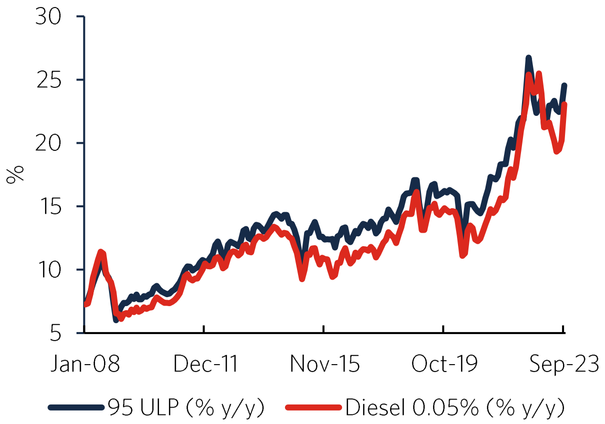
Chart 4: Oil prices to remain higher into November 2023



Source: EIA, Momentum Investments
Data until December 2024

The rand weakened to an average of R18.8 against the US dollar in August. The weaker rand and higher oil prices in August resulted in larger fuel price increases of R1.71/l for both grades of petrol and R2.84/l for diesel (0.05%) in September. These increases have reversed most of the price cuts over the past months (see chart 5) and the impact thereof will be reflected in higher transport inflation during September, which will place upward pressure on headline inflation.

Chart 5: Climbing fuel prices



Source: IRESS, CEF, Momentum Investments

We can expect a further fuel hike in October. This is underpinned by the EIA's forecast of higher international oil prices (average price above US$90/bbl in September) and the exchange rate trading weaker at an average of R19.02 against the US dollar in September (month-to-date). The CEF is estimating an under-recovery of R1.24/l for petrol (95) and R1.97/l for diesel (0.05%) as at 18 September. As such, we can expect transport deflation to moderate further in October.

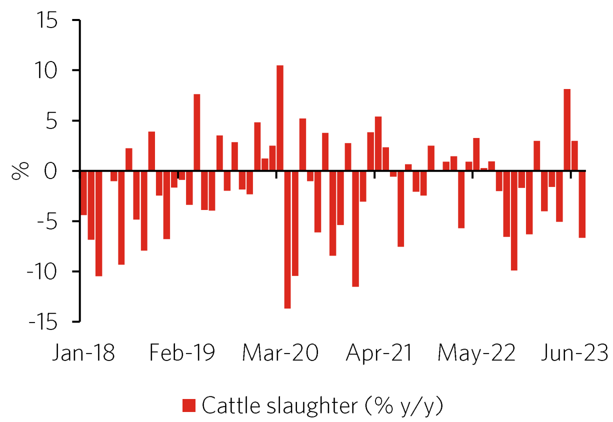
Food inflation drops into single digits and is expected to continue to moderate

Contrary to upward pressure on transport inflation, food inflation is expected to soften further over the coming months. The SARB expects food inflation to decelerate for at least another six months on the back of good crops and cattle restocking following the widespread foot-and-mouth disease that affected six of the nine SA provinces in 2022. Agbiz expects food inflation to average between 9.5% and 9.9% in 2023 and decline to 7% in 2024.

Food price inflation decelerated to 8.2% y/y in August, from 10% y/y in July. This brought the contribution of food and NAB toward the headline inflation rate down from 1.7% in July to 1.4% in August. The decrease in food inflation was broad-based as eight of the nine food groups recorded lower inflation rates in August. Bread and cereals decreased notably from 13.1% y/y in July to 9.9% y/y in August. This was followed by milk, eggs and cheese (11.9% y/y from 14.4% y/y) and meat (3.6% y/y from 5.1% y/y).

Since the spread of the foot-and-mouth disease which led to a reduction in cattle slaughtering, there was a sharp increase (8.1% y/y) in the number of cattle slaughtered in April 2023 and May recorded a 3% y/y growth rate (see chart 6). Slaughtering plummeted by 6.6% y/y in July and this resulted in the total number of cattle slaughtered in the first seven months of the year being marginally lower (0.5% y/y) than the same period a year ago. This has the potential to raise beef prices and slow the moderation in meat and overall food inflation.

Chart 6: Slaughtering down 6.6% y/y in July 2023



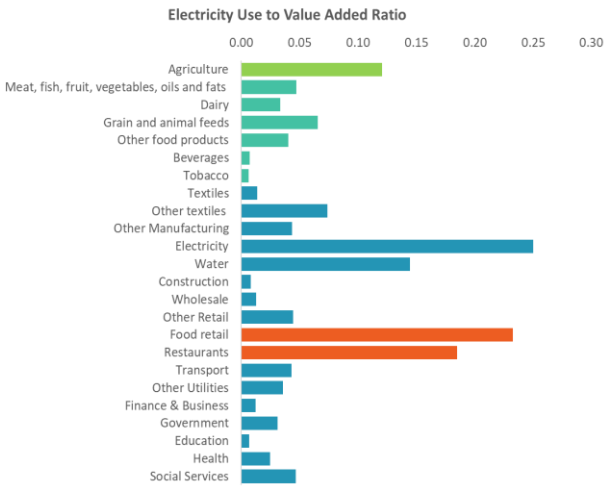
Source: Red meat levy admin, Momentum Investments
Data until July 2023

Another pressure point on meat inflation is the reintroduction of the poultry tariffs flagged in the August CPI note (July data). Agbiz notes that these tariffs are inflationary but warns that revisions to the tariffs may only be possible from mid-2024. This means chicken prices will likely trend upward until next year.

The revision of poultry tariffs is one of the factors informing Agbiz's lower estimate for food inflation in 2024. Another contributing factor is the sector's investment into reducing reliance on Eskom. According to Agbiz, getting off the grid (installing solar and batteries) comes at a hefty cost of R22 million for an average sized farm. The Department of Agriculture, Land Reform and Rural Development launched a R1.2 billion Agro-Energy Fund to assist farmers with renewable energy investment. Having backup power is crucial for the sector because agriculture has one of the highest use-to-value added ratios in the economy (see chart 7). Energy self-generation capabilities will ensure that farmers can operate with minimal disruptions and irrigation will be less of a constraint, especially if El Niño intensifies.

Agbiz maintains that El Niño is not a big risk to food inflation in the near term and the current soil moisture provides an opportunity for farmers to start farming early (ahead of El Niño). Moreover, the impact of drier weather will unlikely be as extensive as in 2015/2016 because research and development over the years has improved the quality of the seeds used in the industry.

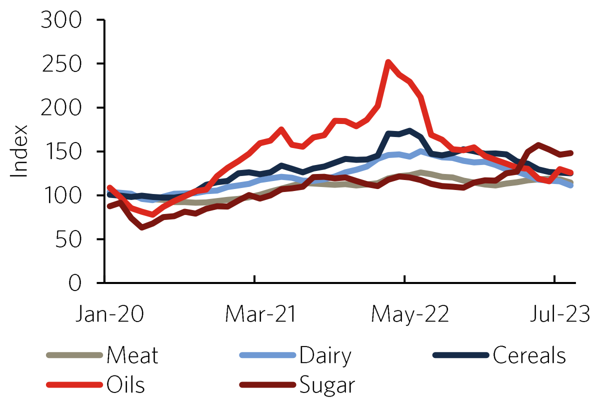
Chart 7: Agriculture use-to-value added ratio is 12%



Source: Agbiz

Internationally, the nominal UN FAO Food Price Index dropped by 2.1% m/m in August 2023, reversing the 1.1% m/m increase in July that was partly driven by uncertainties around the expiration of the Black Sea Grain Initiative. The drop in August was mostly due to a decrease in the meat, dairy and oils price indices. The sugar price index increased by 1.3% m/m in August and was 34.1% higher than a year ago while all the other sub-indices were lower relative to August 2022 (see chart 8). The August sugar price index was higher due to rising concerns about the impact of El Niño on production. Domestically, inflation in sugar, sweets and desserts is the fastest growing from the food basket (18.5% y/y in August).

Chart 8: Sugar price index remains elevated



Source: Red meat levy admin, Momentum Investments

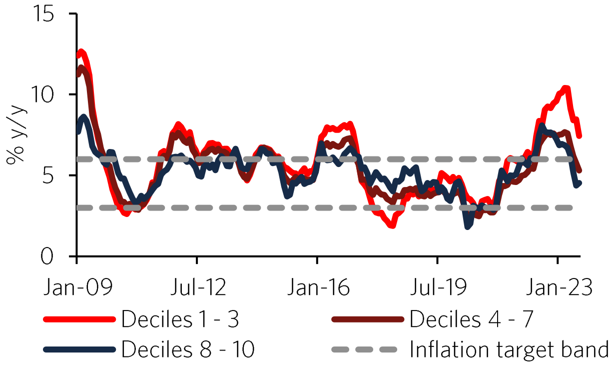
According to the FAO, maize prices in August were at the lowest value since September 2020 due to abundant global supply. In SA, the Crop Estimates Committee (CEC) estimates 2023 maize crops to be 6.1% more than in 2022 with majority of the increase coming from white maize.

The 78th session of the UN General Assembly (UNGA 78) taking place between 18 and 26 September provides an opportunity for world leaders to engage in discussions about restoring the Black Sea Grain Initiative. *UN Dispatch* notes that major developments are unlikely but focusing on these conversations throughout the session may yield good results down the line.

Upward price pressure for higher expenditure deciles ahead

The inflation rate of households in expenditure deciles one to three dropped significantly to 7.4% y/y in August from 8.5% y/y in July. This is largely owing to the decrease in food and NAB because this group of households spend the bulk of their budget on food and NAB. If food and NAB continues to moderate over the next six months as projected, the inflation rate experienced by households in deciles one to three may continue to come down from the still elevated levels (see chart 9).

Chart 9: Upper deciles will likely experience higher inflation in the coming months

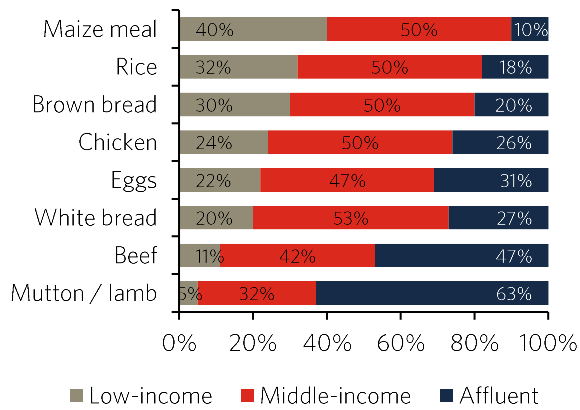


Source: Global Insight, Stats SA, Momentum Investments
Data until August 2023

On the other hand, the inflation rate experienced by households in deciles eight to 10 increased slightly to 4.5% y/y in August from 4.4% y/y in July. This was possibly driven by the moderation in the rate of fuel deflation. Inflation experienced by these households will likely accelerate in the coming months on the back of higher fuel prices because they spend a sizeable portion of their budget on transport.

Although affluent households spend a smaller portion of their budget on food relative to low-income households, the composition of their food basket is vulnerable to upside pressure through the higher spend on beef (less slaughtering) and expenditure on chicken (tariffs) as seen in chart 10.

Chart 10: Affluent households spend a larger portion of their wallet on meat



Source: Agbiz, Momentum Investments

SARB expected to keep rates constant

While the August CPI figure ticked up slightly, headline inflation is still contained close to the midpoint of the inflation target range due to the larger-than-anticipated drop recorded in July. We note upside pressure stemming from fuel price hikes in the very near term, however, according to the EIA's forecast on Brent crude oil, the pressure will subside from December (provided the rand does not weaken substantially from the current levels).

Taking the above into consideration, we maintain our view of another repo rate pause at the upcoming September 2023 interest-rate setting meeting, but the tone will likely be hawkish to reflect upward pressure on transport inflation, concerns over the volatility of the currency, higher administered prices and the risk of El Niño.

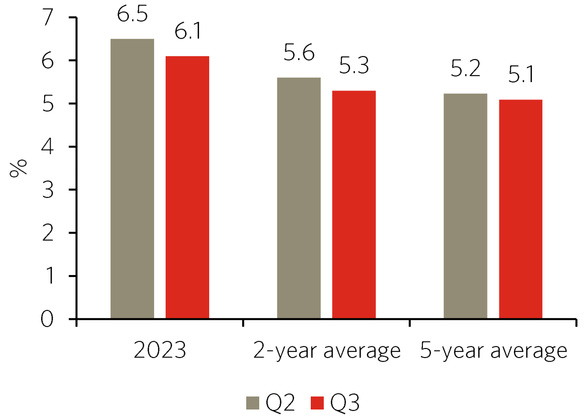
The SARB will likely find comfort in the possibility of a further deceleration in the inflation rate experienced by lower income households as food inflation continues to soften as well as the improvement in the third quarter inflation expectations published by the Bureau for Economic Research (BER).

The markedly lower average inflation expectation of 6.1% for 2023 from 6.5% (see chart 11) in the third quarter signal that the initial interest rates are affecting aggregate demand in the economy which provides further support for the SARB to continue with the wait-and-see approach. Furthermore, the two-year ahead and five-year average expectations were also revised downward to 5.3% (previously 5.6%) and 5.1% (previously 5.2%), which is positive for the SARB's expectation of inflation being on the glide path toward the midpoint (4.5%). Businesses and trade unions were responsible for the drop in expectations across the different forecast periods.

We expect the SARB to maintain a restrictive stance on monetary policy in light of fiscal dominance fears and persistent upside risks to the inflation profile, including the rand, loadshedding and administered prices.

As such, we only expect the first cut in interest rates in the second quarter of 2024.

Chart 11: Broad-based improvement in third quarter average inflation expectations



Source: Global Insight, Stats SA, Momentum Investments