momentum investments

The Macro Research Desk

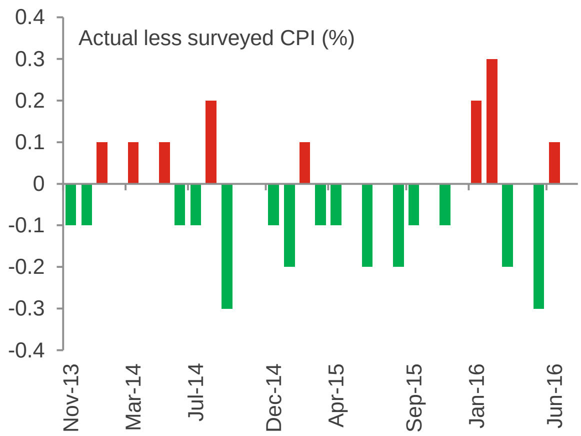
From left to right: Herman van Papendorp (Head of Investment Research and Asset Allocation), Sanisha Packirisamy (Economist)

No surprise in June headline inflation print

Headline inflation broadly in line with expectations

According to Stats SA, headline inflation rose to 6.3% y/y in June from 6.1% in May, in line with our own estimate and only marginally higher than the market's expectations (see chart 1). In monthly terms, inflation rose by 0.6% as a result of rental inflation and an increase in transport prices.

Chart 1: Headline CPI broadly in line with market expectations



Source: Stats SA, Bloomberg, Momentum Investments

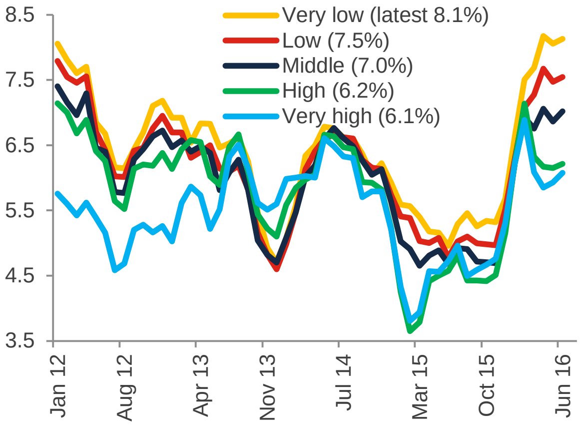
June is a relatively high survey month, with more than a third of the basket (including rental inflation) surveyed in addition to the normal monthly surveys. Relative to our own forecasts, the price increases related to food, clothing and vehicles surprised to the downside, while price increases in public transport, restaurants and hotels surprised to the upside.

High food prices driving inflation differential between low- and high-income earners

Although food prices tracked sideways over the month (-0.1% m/m), the year-on-year rate rose to 11.0% y/y. The price of bread and cereals rose to 14.8% y/y in June (prev. 14.5% y/y), while meat inflation slowed to 5.9% y/y from 6.3% y/y in April. Volatile fruit and vegetable inflation remained high at 12.1% and 18.4% y/y, respectively.

With food accounting for over 35% of lower-income earners' consumer baskets, escalating food prices have resulted in a higher rate of inflation (8.1% y/y) in the very low income earning group (those earning up to R21 399 per annum), while the headline rate of inflation in the very high income earning group (earning more than R142 084 per annum) registered at nearly 2% lower (see chart 2).

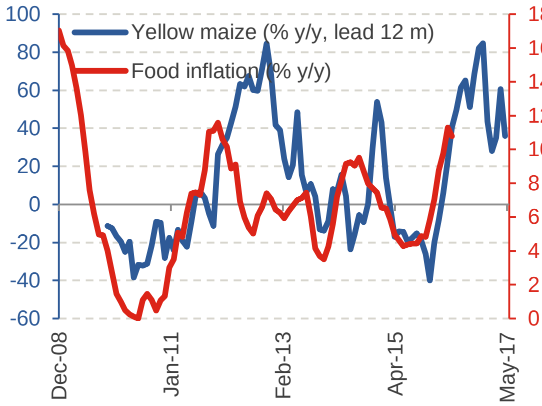
Chart 2: Inflation per income-earning group (% y/y)



Source: Stats SA, Global Insight, Momentum Investments

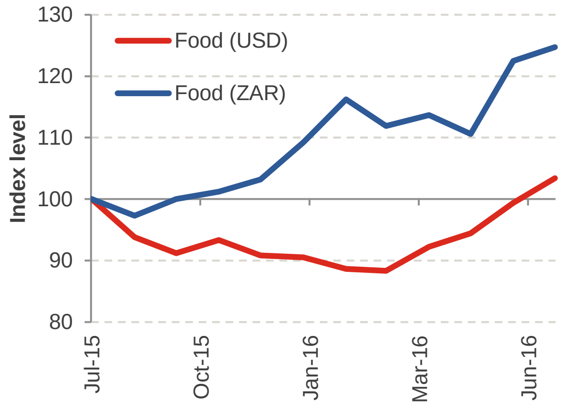
A further drop in yellow maize prices signals some relief in food inflation further down the line. Using a twelve-month lead in the rand value of yellow maize prices points to a marked improvement in the food inflation trajectory in 2017 (see chart 3). Nonetheless, short term risks remain. Imports to cover SA's maize shortfall are expected later in the year which could drive food prices higher before expectations of more favourable weather conditions drive food inflation lower in 2017. Moreover, global food prices, although still low, have risen to 3.4% y/y (see chart 4).

Chart 3: Rand maize prices dipping lower



Source: Stats SA, Global Insight, Momentum Investments

Chart 4: Global food inflation lifting off a low base



Source: Stats SA, Global Insight, Momentum Investment

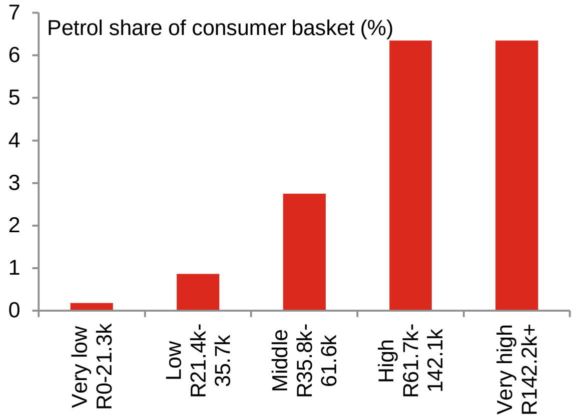
Steep hike in June petrol price set to reverse over the next two inflation readings

A 52c/l hike in the price of petrol in June led to a monthly 3.4% rise in private transport prices. However, owing to favourable base effects, the year-on-year rate remained low at 0.2%. An 8c/l hike in July and the current 86c/l over-recovery estimated for August (based on the rand and dollar-oil price movements for the month to date) suggest that annual private transport inflation will dip marginally into negative territory over the next two inflation readings, contributing to a temporary dip in the headline print over the corresponding period. The rand price of oil has fallen by nearly 15% since its recent peak at the end of May due to both a fall in international oil prices as well as an appreciation in the local currency. The rand has strengthened in line with the recent rally in emerging market assets on expectations of further easing by monetary and fiscal authorities in key developed markets in response to Britain's decision to exit the European Union.

We expect the private transport category to become a larger contributor to headline inflation in 2017 on the back of a depreciation in the local currency (driven by fragile domestic macro fundamentals, still-weak commodity prices and the threat of rising interest rates by the US Federal Reserve) and a gradual uptick in international oil prices.

Although the expected temporary dip in private transport inflation should bring about some temporary relief to the SA consumer, it is most likely to benefit the upper-income earning groups that spend a larger allocation of their budget on private transport costs (see chart 5), thus limiting the benefit for lower-income earners. With lower-income earners largely dependent on public transport, the benefit of lower petrol prices may be felt less should the decline in petrol prices not be passed on in full. Moreover, elevated food inflation continues to erode real disposable income growth for this end of the income-earning spectrum.

Chart 5: Upper-income earners more exposed to changes in the petrol price

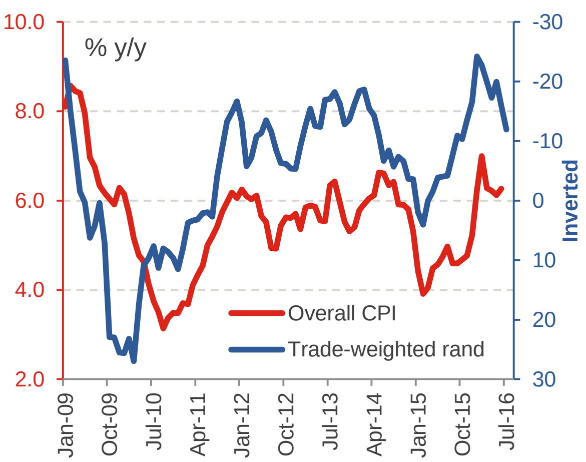


Source: Stats SA, Momentum Investments

Marginal uptick in core inflation

Weak domestic demand has limited the pass-through from a weaker trade-weighted currency into the domestic consumer spending basket. Core inflation (excluding food, beverages, petrol and energy) increased marginally to 5.6% y/y in June from 5.5% in May, despite the trade-weighted rand depreciating by nearly 16% between June 2015 and June 2016 (see chart 6). We expect core inflation to track slightly higher over upcoming months, but to remain below the upper band of the 3% - 6% inflation target band as muted domestic demand prevents a larger pass-through from rising input costs.

Chart 6: Weak domestic demand has limited currency pass-through to date



Source: Stats SA, Momentum Investments

Reserve Bank likely to hold interest rates steady at July 2016 Monetary Policy Committee (MPC) meeting

The recent reprieve in the domestic currency, brought about by expectations of further stimulus efforts by major central banks, should see the SA Reserve Bank lowering their expectations for headline inflation, while muted confidence levels are expected to lead to a marginal cut in the SARB's growth forecasts. As such, we are not anticipating an interest rate increase at the upcoming MPC meeting.

However, we believe that a further interest hike of 25 basis points cannot be ruled out before year end. Although we expect inflation to dip over the next two months due to lower petrol prices, elevated food inflation and the impact of previous currency weakness should lead to a rise in inflation into the fourth quarter of the year. Despite a weak growth backdrop, inflation expectations remained high in the first quarter of the year (2Q16 release scheduled for 21 July 2016), threatening the outlook for second-round inflation impacts. Moreover, SA's extended current account deficit remains highly reliant on volatile capital inflows. As such, maintaining an attractive real rates profile remains key in funding SA's external imbalance.

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