momentum investments

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in the moment

CPI spikes to 5.4% y/y in September on higher fuel prices

Highlights

- According to Statistics South Africa (Stats SA) headline inflation (CPI) surged to 5.4% year-on-year (y/y) in September 2023 from 4.8% y/y in August following the recent low of 4.7% y/y in July. In contrast, core inflation moderated to 4.5% y/y in September from 4.8% y/y in August, highlighting subdued underlying demand.
- Headline inflation registered slightly above the Reuters median consensus of 5.3% y/y while core inflation was lower than the expectation of 4.7% y/y.
- Higher headline inflation was predominantly driven by the reversal of transport prices from deflation (negative 0.8% y/y in September) to an inflation rate of 4.2% y/y in September. This was on the back of higher fuel prices and fading base effects. Renewed upward pressure from fuel prices over the past two months comes after 11 consecutive months of a deceleration in transport inflation, which largely drove down CPI.
- The tables have turned with softer food inflation alleviating pressure on headline inflation after being the main culprit for elevated price pressures in the past couple of months. Food inflation decreased slightly to 8% y/y in September from 8.2% y/y in August.
- The outbreak of the Avian flu has resulted in shortages of eggs and poultry products, leading to higher prices for these food categories. This presents potential upward pressure on food prices but a temporary rebate on anti-dumping duties on chicken meat imports could alleviate shortages and price pressures.
- Global food prices proxied by the United Nations Food and Agricultural Organisation (FAO) Food Price Index remained broadly unchanged in September but is still well below 2020 and 2021 levels.
- A potential escalation in the Israel-Gaza conflict could raise international oil prices even further, which initially increased on the back of oil supply cuts by major oil producers. As such, higher international oil prices and a weaker currency are ongoing concerns for local fuel prices and the trajectory for domestic inflation.
- According to the Central Energy Fund (CEF), petrol prices increased in October following a notable increase in September. The price of petrol (inland 95) increased by R1.14/l and diesel increased by R1.97/l, which will drive transport inflation higher in October. Some reprieve may be experienced in November with the estimated over-recovery on 16 October pointing to a price drop of above R1.90/l for both grades of petrol and a marginal drop of R0.78/l for diesel (0.05%).
- Despite the uptick in headline inflation, we expect the SA Reserve Bank (SARB) to keep rates constant at 8.25% in the November 2023 interest rate-setting meeting given that the higher interim inflation rate was anticipated by the SARB, third quarter inflation remained in line with the SARB's forecast and demand-pull inflation appears contained.

- Nevertheless, the Monetary Policy Committee (MPC) will likely maintain a hawkish tone given the risks to the inflation trajectory including the Avian flu outbreak, higher medical insurance inflation in 2024, a continuous increase in international oil prices, a weaker exchange rate, El Niño, higher administered costs, loadshedding, potentially higher average salaries, the chance of higher inflations expectations and fiscal dominance. Consequently, we continue to forecast interest rates remaining high for longer with the likelihood of cuts commencing in the second quarter of 2024, at the earliest.

Rental inflation surprises positively signalling contained demand-pull inflation

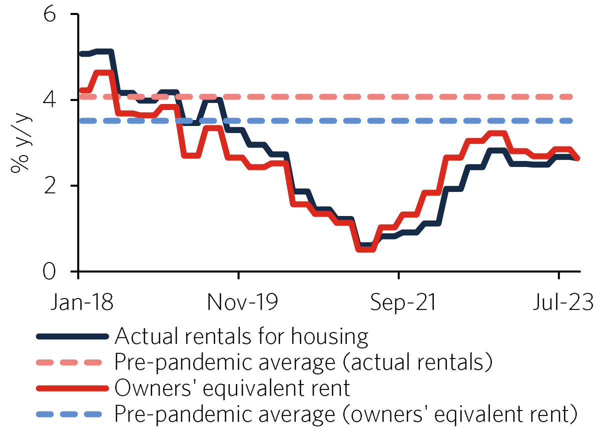
Stats SA reported headline inflation at 5.4% y/y in September 2023, up from 4.8% y/y in August. The acceleration was anticipated but registered slightly higher than the Reuters median consensus of 5.3% y/y. The higher inflation rate was predominately driven by transport inflation soaring from negative 0.8% to 4.2%. On a month-on-month (m/m) basis, CPI rose by 0.6% compared to 0.3% m/m in August.

Core inflation registered a m/m rate of 0.2% resulting in a y/y increase of 4.5% in September, lower than 4.8% y/y in August. Similar to headline inflation, softer core inflation was anticipated but the rate of deceleration was more than anticipated (Reuters median consensus: 4.7% y/y). The percentage of underlying inflation categories recording inflation of above 6% fell from 53% in August to 32% in September, further suggesting reduced broad-based inflationary pressures in the economy.

September is a high survey month. An additional 21% of the basket is surveyed every September aside from the regular monthly surveys. These items include rental costs (actual and owners' equivalent rent), domestic workers' wages, motor vehicle insurance as well as taxi, train and local bus fares.

The marginal decrease in rental inflation was not expected. Actual rentals for housing dipped to 2.6% y/y in September (2.7% y/y in June) and owner's equivalent rent decreased to 2.6% y/y (2.9% y/y in June). Rental inflation remains relatively well contained and tracks below pre-pandemic levels as seen in chart 1.

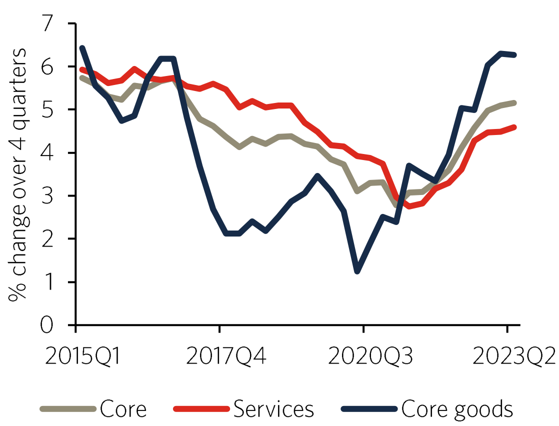
Chart 1: Rental inflation dips in September



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

Muted rental inflation as well as lower-than expected medical inflation has kept services inflation and consequently core inflation contained (see chart 2). Core inflation was predominantly driven by core goods inflation.

Chart 2: Services inflation remains contained

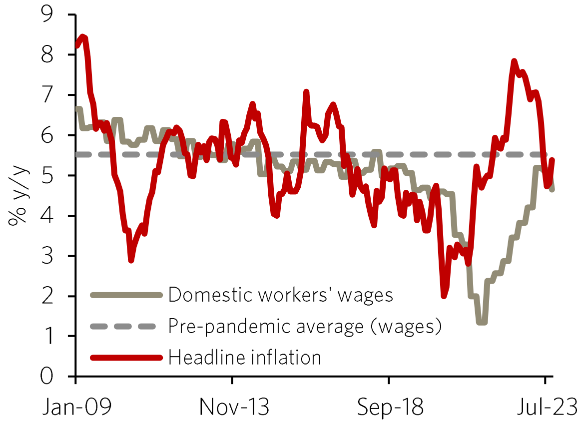


Source: SARB, Momentum Investments

According to *Moneyweb*, the Council for Medical Schemes (CMS) advised medical insurances to limit contribution increases for 2024 to 5% (in line with inflation), being cognisant of the difficult economic environment that face consumers. Some medial insurances have started announcing rate increases for 2024 which are above the CMS' advised limit. *News24* notes 2024 weighted-average contribution increases from the three largest medical schemes as 7.5% by Discovery, 9.6% by Momentum and 6.9% from Bonitas, effective from January 2024. However, the CMS has not yet approved these contribution increases. Above-average increases, if approved and implemented, will likely put upward pressure on services and core inflation rates.

Domestic workers' wages inflation (accounts for 2.53% of headline inflation) has picked up following the pandemic-induced collapse, but the rise did not keep up with headline inflation as seen in chart 3. However, the upward trend reversed in the past two survey results with the increase in domestic workers' wages moving below headline inflation. Domestic workers' wages decreased to 4.7% y/y in September 2023 from 5.1% y/y since the last survey in June 2023.

Chart 3: Domestic workers' wages inflation near pre-pandemic average



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

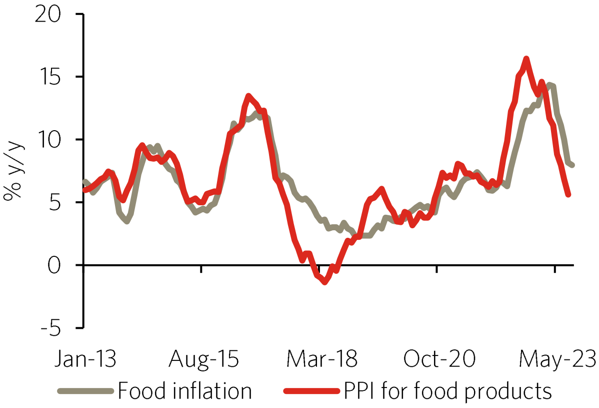
Goods inflation registered at 6.8% y/y in September, higher than 5.6% y/y in August. Services inflation remained constant at 4% for the third consecutive month. The uptick in goods inflation has resulted in a wider gap between these two indices.

Domestic food inflation continued to soften

Domestic food inflation continued to moderate, dropping for the sixth consecutive month to 8% y/y in September from 8.2% y/y in August (see chart 4). Five of the nine food groups registered a lower inflation rate in September. The rate of oils and fats deflation moderated sharply from 13.9% y/y in August to \ 7.7% y/y in September as the impact of base effects are starting to retreat. .Non-alcoholic beverages (NAB) inflation accelerated to 8.6% y/y in September from 7% y/y in August and resulted in food and NAB inflation ticking up slightly to 8.1% y/y (previously 8% y/y)

On a producer level, inflation for food products decelerated to 5.6% y/y in August from 6.8% y/y in July. The drop was recorded in the meat, fish, fruit, vegetables, oils and fats as well as grain mill products, starch and animal feeds categories. This outweighed the increase in dairy products and other food products. On the back of the continuous decrease in producer inflation for food products, food inflation is likely to continue decelerating in the coming months.

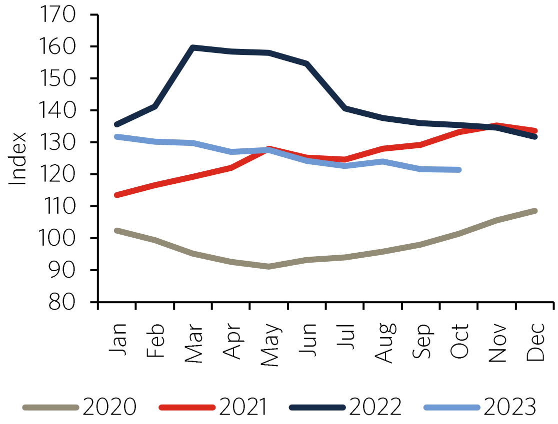
Chart 4: Food inflation plummets from peak at consumer and producer level



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

A recent pressure point in producer and consumer inflation has been the widespread outbreak of two strains of Avian flu, mostly affecting five of the nine provinces in SA (Free State, Gauteng, Limpopo, Mpumalanga and North West). To contain the outbreak, millions of chickens were culled and the cost to producers is estimated at R550 million, according to the *Daily Maverick.* Culling has created a shortage of eggs and poultry products and consequently led to higher prices. The *Daily Maverick* reports that the Department of Trade, Industry and Competition (DTIC) requested the International Trade Administration Commission (ITAC) on 3 October to consider a temporary rebate on anti-dumping duties on chicken meat imports which were recently reinstated in August 2023. This may be an immediate solution given that the estimated time to address the shortage is between six and 12 months. A longer-term intervention by government includes introducing chicken vaccinations (chickens are currently not being vaccinated).

Chart 5: Global food prices steadily coming down



Source: Global Insight, Stats SA, Momentum Investments

Internationally, the FAO Food Price Index remained broadly unchanged at 121.5 points in September (previously 121.6 points) as seen in chart 5. The price indices of meat, dairy and vegetable oils declined but this was offset by an increase in the sugar and cereal price indices. Nevertheless, the index is lower than levels reached in 2020 and 2021.

Renewed risks to international oil prices

International oil prices increased during September 2023 and started to fall in the first week of October. The retraction in October was, however, temporary and oil prices are expected to increase in the coming months.

According to the United States (US) Energy Information Administration (EIA), Brent crude oil averaged US$93.7/ bbl in September 2023. This was higher than the initial estimate of US$92/bbl and the average price of US$86.2/bbl recorded in August, largely due to voluntary production cuts implemented by Saudi Arabia and lower US commercial crude oil inventories.

The price of Brent crude oil fell from the recent peak of US$94.3/bbl reached toward the end of September to US$84.1/bbl in the first week of October, but prices have since been on an upward trajectory. According to Reuters, the recent surge may be attributed to the Israel-Gaza conflict (began 7 October 2023), which led to prices rising by almost 6% in the first week of the conflict as well as US sanctions on Russian tankers which could reduce supply. The increase in prices on the back of the conflict in the Middle East is deemed as an initial price reaction because it had little impact on global oil and gas supplies. The EIA has not yet included the conflict in its baseline forecast of US$84.09/bbl in 2023 (previous estimate slightly higher at US$84.49/bbl). The IMF notes that it is still too early to determine the economic impact of this conflict but highlighted that past experiences have shown that a 10% increase in oil prices could hamper global output by 0.15% and increase global inflation by 0.4% in the following year. As such, the conflict has the potential to place upward pressure on prices, but more certainty will prevail as the situation unfolds.

Bloomberg Economics warns that the conflict in the Middle East could have a bigger impact on inflation and growth if more countries get involved. The impact is examined under three different scenarios acknowledging that there is a wider range of possible outcomes and risks. The first scenario assumes that the war remains confined to Israel and Gaza, the second scenario describes an escalation into a proxy war involving Lebanon and Syria, and the third scenario is a direct war between Israel and Iran wherein oil prices could reach US$150/bbl and trigger a global recession, but the probability of this eventuality is seen to be low. See table 1 for details of these three scenarios.

Table 1: Economic impact of the Israel-Gaza war could be more pronounced

Scenario	Details	Impact on oil prices and VIX*	Impact on global GDP and inflation**
1 – Confined war	- Ground invasion of Gaza - Limited broader regional conflict - Lower Iranian crude output	Oil: +US$4/barrel VIX: No impact	GDP: –0.1%. Inflation: +0.1%
2 – Proxy war	- Multifront war in Gaza, West Bank, Lebanon, Syria - Unrest in wider Middle East	Oil: +US$8/barrel VIX: +8 points	GDP: –0.3% Inflation: +0.2%.
3 – Direct war	- Israel and Iran in direct conflict - Unrest in wider Middle East	Oil: +US$64/barrel VIX: +16 points	GDP: –1.%. Inflation: +1.2%.

Source: Bloomberg

* *Impact calibrated based on 2014 Gaza War, 2006 Israel–Lebanon War, and 1990–1991 Gulf War.*

** *Impact on year-on-year change in global GDP and inflation for 2024, estimated using Bayesian Global VAR.*

The EIA markedly revised the average price of crude oil for 2024 up to $94.91/bbl in October from $88.22/bbl in September. We note that the EIA's forecasts are higher than the SARB's and the IMF's forecasts as detailed in table 2. Estimates for 2023 are broadly aligned while 2024 has a wider range.

Table 2: EIA oil price forecast is more pessimistic (US$/bbl)

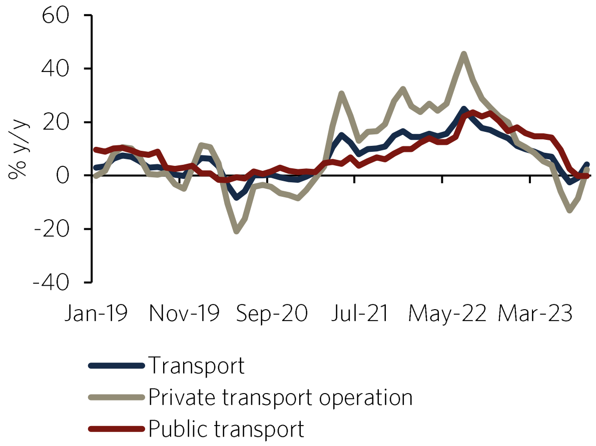
	EIA	SARB	IMF
2023	84.09	82	80.49
2024	94.94	82	79.92

Source: EIA's October Shor-term energy outlook, SARB's September MPC, IMF's October World Economic Outlook

Transport inflation shot up to 4.2% y/y in September from negative 0.8% y/y in August, resulting in a switch from the transport category detracting from headline inflation (negative 0.1 in August) to contributing 0.6% to the 5.4% headline figure. This was predominately driven by the sizeable fuel price increases (R1.71/l for both grades of petrol and R2.84/l for diesel (0.05%)) in September, which led to private transport inflation increasing by 2.1% y/y from negative 8.6% y/y in August (see chart 6).

We expect further upside pressure on transport inflation in October from higher fuel prices. According to the CEF, the price of petrol (inland 95) increased by R1.14/l in October and diesel (0.05%) increased by R1.97/l due to higher international oil prices in September as well as a weaker exchange rate. The rand averaged R19.02 against the US dollar in September compared to R18.78 in August. Early data from the CEF points to some reprieve in November. According to the current over-recovery estimates published for 16 October 2023, the price of both grades of petrol may drop by above R1.90/l and a marginal drop of R0.78/l for diesel (0.05%).

Chart 6: Transport deflation reversed



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

SARB's inflation trajectory remains intact

The SARB published an inflation forecast of 5.1% (downward revision from 5.4%) for the third quarter of 2023 in the September 2023 interest rate-setting meeting. Despite the downward revision and an uptick in the August and September inflation rates, average inflation in the third quarter surprised positively at 5%. This may only be a slight positive surprise, but it indicates that inflation is within the SARB's projected inflation trajectory. This implies that rates are currently sufficiently restrictive to ensure that inflation continues to moderate toward the midpoint of the inflation target band. As such, we expected the SARB to keep rates constant at 8.25% at the November interest rate setting meeting, but to maintain a hawkish tone as risks remain elevated. As detailed earlier in this report, the risks include the Avian flu outbreak, higher medical insurance inflation in 2024, a continuous increase in international oil prices and a weaker exchange rate. This is in addition to the previously communicated risks attached to drier weather conditions, higher administered costs (water and electricity), loadshedding, and potentially higher average salaries. The SARB continuously communicates that there is still a possibility of a hike, which could be triggered by inflation rising by more than projected if these risks materialise.

The muted rental costs which point to contained demand-pull inflation and softer inflation expectations in the previous survey results will likely support the argument to keep rates constant. The upcoming Bureau for Economic Research (BER) inflation expectation survey scheduled for publication prior to the November MPC meeting will be an important consideration by the members. Outcomes of this survey may give guidance on whether respondents are dominantly forward-looking or depend on spot inflation to formulate their expectations. The SARB notes that inflation expectations dominated by respondents influenced by previous and spot inflation makes the task of monetary policy more difficult and could prolong the disinflation process.

The Medium-Term Budget Policy Statement (MTBPS) will be tabled on 1 November 2023 (prior to the interest rate setting meeting). We expect the government to announce a wider fiscal deficit on the back of mounting fiscal pressures. As previously noted, a more fragile fiscal environment places upward pressure on the country's risk premium, which is a concern for the SARB. Consequently, we expect monetary policy to remain restrictive to guard against fiscal dominance risk and we maintain our stance of rates being kept high for longer with the first cut in the second quarter of 2024, at the earliest.