



## Price pressure stems from medical and food inflation

### Highlights

- According to Statistics South Africa (Stats SA), consumer price inflation (CPI) rose to 7% year-on-year (y/y) in February, slightly up from 6.9% y/y in January and against market expectations of 6.9% y/y. On the other hand, core inflation picked up more notably to 5.2% y/y from 4.9% y/y largely due to higher services inflation (medical insurance, hotels and accommodation).
- Medical insurance (representing 7.1% of the headline basket) rose by 7.5% y/y in February from 4.8% y/y in January given that various medical aids announced higher premiums. We are likely to see another notable increase in April when the remaining medical aid schemes put through their premium increases.
- Food and non-alcoholic beverages (NAB), housing and utilities, transport and miscellaneous goods and services were the main drivers of headline CPI in February.
- International oil prices increased slightly in January 2022, thus leading to high fuel prices. However, transport inflation eased further in February. The Central Energy Fund (CEF) announced an increase of R1.27/l in the price of petrol and 30.4 c/l in diesel in March. Nevertheless, we expect transport inflation to remain broadly on a downward trend given the high base effect of last year.
- On the other hand, the trajectory of food inflation is less certain as pressures continue to surprise on the upside. White maize futures prices have been decreasing and signal towards food inflation softening. However, high diesel costs, lower production in the agriculture sector due to loadshedding and the weaker rand pose upside risks to food inflation in the near term.
- The acceleration in food and NAB inflation has been mainly due to bread and cereal prices as well as higher meat prices. The month-on-month (m/m) increase of 1% in February was less than 1.8% m/m in January.
- Foot-and-mouth disease and lower cattle slaughtering have increased red meat prices. However, both factors are contained and red meat prices are expected to trend sideways in 2023.
- Persistently high food inflation has a greater effect on more vulnerable consumers (expenditure deciles one to three)<sup>1</sup>. This group's inflation rate in February was 10.1%. That is 3.1% higher than headline CPI.
- Surveyed inflation expectations for this year and next year have been revised higher as more risks have materialised, but longer-dated expectations have remained broadly unchanged.

<sup>1</sup> Deciles one to three: up to R48 673 per annum

- Given broadening pressures in inflation and the upside risks to the inflation outlook, particularly food inflation, we maintain our view of a 25-basis point increase at the March Monetary Policy Meeting (MPC). However, we note that risks for a more hawkish stance are higher in light of renewed global financial stability risks.

## Higher services inflation the culprit behind higher core inflation

Headline inflation rose to 7% y/y in February 2023 after easing for three consecutive months. The market had expected inflation to remain constant at 6.9% y/y, according to the Reuters median consensus. On a month-on-month basis, CPI rose 0.7%.

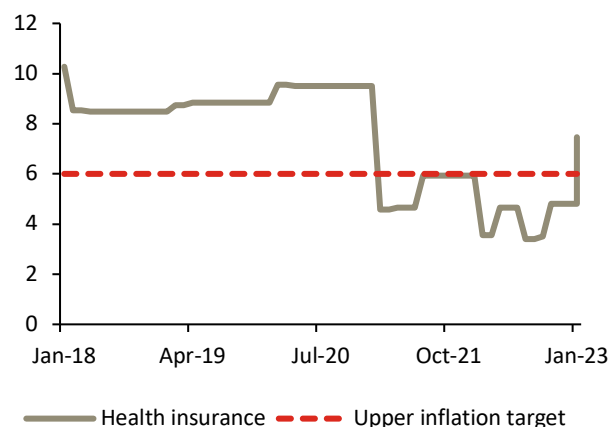
Food and NAB (13.6% y/y), transport (9.9% y/y), housing and utilities (4.0% y/y) and miscellaneous goods and services (6.1% y/y) remained the main drivers of inflation contributing 2.3%, 1.4%, 1.0%, and 0.9% to headline CPI, respectively.

The contribution of transport inflation decreased from 1.6% in January to 1.4% in February. On the other hand, miscellaneous goods and services contributed 0.9% to inflation in February, up from 0.7% in the previous month on account of higher medical insurance. Therefore, these contribution changes cancelled out and CPI was higher by the 0.1% contribution from the residual component.

Core inflation rose to 5.2% in February, up from 4.9% in January. This was due to higher services inflation of 4.6%, from 4.3% in January, because of higher medical insurance inflation and hotel inflation. Higher core inflation is indicative of second-round effects in the consumer basket. The number of categories recording price increases of above 6% increased to 14 out of 28 (58% of the weighted basket). The last time this many items increased by more than 6% was in July 2014.

Medical insurance (which accounts for 9.6% of the core basket) was surveyed in February and will be surveyed again in April this year. As illustrated in chart 1, medical insurance escalated to 7.5% y/y, above the upper inflation target, in February from 4.8% y/y in January.

**Chart 1: Health insurance shot up**

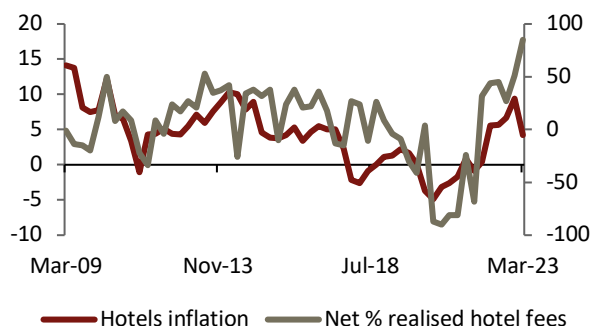


Source: Global Insight, Momentum Investments  
Data until February 2023

As mentioned in the February CPI report, medical insurance has been low since February 2021 when medical schemes implemented small rate increases. This was done to help consumers cope with the impact of the COVID pandemic during 2021 and the high interest rates and inflation in 2022. Various medical aids have announced higher increases for 2023, which have led to the higher medical aid inflation. However, the three largest schemes (Discovery, Bonitas and Momentum Health) have deferred increases to April 2023. As such, medical insurance will likely rise again in April.

Apart from medical insurance, the other category which recorded a substantial rise in inflation was the hotel industry from 2.3% y/y in January to 6.1% y/y in February. This coincides with results from the Services Survey published by the Bureau of Economic Research (BER).

**Chart 2: Hotels inflation increases in line with hotel fee increases**



Source: BER, Momentum Investments

Hotels inflation for the third quarter of 2023 = average of January and February

According to the first quarter Services Survey, confidence in the hospitality sector improved to 75 from

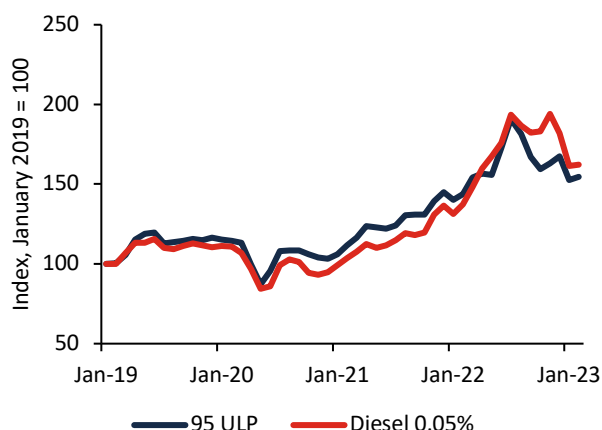
73. This was mainly due to the large improvement in the index for realised profitability which picked up from 27 to 77 and fees charged which picked up from 51 to 85. According to the BER, this mirrors higher economic activity in the sector and the increase in hotel rates to pre-pandemic levels.

Inflation for used vehicles lifted to 14.4% y/y in February. This is significantly higher against the historical average (3.3%). Inflation in this category has been significantly high, recording double-digit growth since May 2022. According to TransUnion, used vehicle inflation is higher due to lower supply of quality vehicles. Nevertheless, goods inflation remained unchanged at 9.5% y/y in February.

## High diesel prices, loadshedding and currency weakness pose a threat to food inflation

The price of Brent crude oil increased slightly in January to an average of US\$82.5/bbl. This resulted in small increases in the price of petrol and diesel in February 2023. According to the CEF, the price of petrol (inland 95) increased by 28 c/l to R21.68/l and diesel (inland) increased by 9.16 c/l to R21.32/l in February. Despite these increases, transport inflation eased to 9.9% y/y in February from 11.1% y/y in January.

**Chart 3: Fuel prices moderating but remain high**



Source: IRESS, Momentum Investments

The CEF announced larger fuel increases of R1.27/l in petrol and 30.4 c/l in diesel in March despite international oil prices remaining broadly unchanged in February. This was due to the weaker rand during

February. As at 17 March 2023, the CEF estimates an under-recovery of 8.63 c/l for petrol and an over recovery of 42.65 c/l for diesel which means we can expect an increase in the petrol prices and a decrease in the price of diesel during April.

Although fuel prices have been coming down as seen in chart 3, they are still high and pose a risk to food inflation. In particular, companies are incurring exorbitant diesel costs to operate generators during loadshedding. So far, Shoprite has reported the highest cost of R93 million per month in the second half of 2022 and they estimate to spend R1 billion per year if the current rate of usage continues. Other large companies are also spending millions per month on diesel.

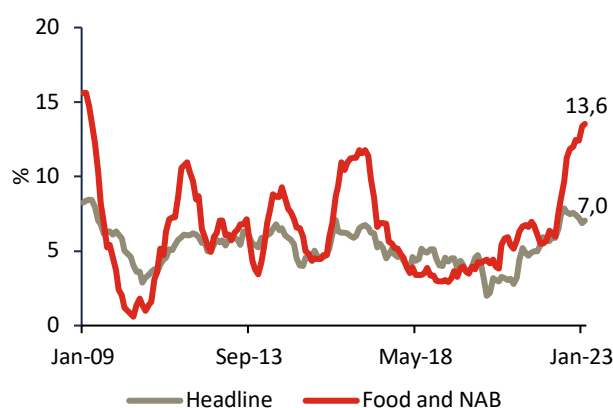
A *BusinessDay* article detailed the predicament of the three largest food and groceries retailers in SA (Shoprite, Pick n Pay and Spar), but this possibly extends to other businesses as well. These retailers indicated that it would be very difficult to hold off passing on the cost of diesel to consumers through higher food prices if diesel costs remain high and there is no support from government. This comes after the 2023 National Budget extended the diesel fuel levy refund to food manufacturers only and not including retailers. The refund system has been in place since 2000 to provide

full or partial relief to primary sectors (farming, forestry, and fishing industry and mining and quarrying).

## Local factors keep food inflation high

Headline inflation has been easing since the peak in July 2022, however, food and NAB inflation has continued to shoot up as illustrated in chart 4. The surge in food and NAB is due to local and global factors including loadshedding, unfavourable weather conditions, animal diseases, geopolitical conflict and the exchange rate.

**Chart 4: Food and NAB inflation has soared**



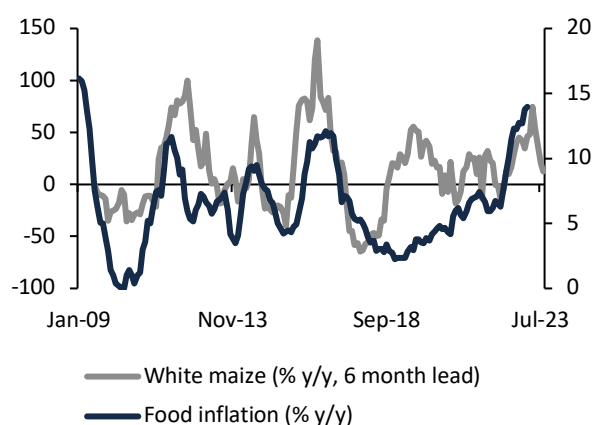
Source: Global Insight, Momentum Investments  
Data until February 2023

As depicted in chart 5, food price changes generally follow the trend of white maize prices (six-month lead). Based on this relationship, the leading indicator points to food prices rolling over in the second quarter of 2023. However, loadshedding poses a risk to wheat prices. According to Agrimark Consulting, maize crops are affected by irrigation disruptions due to loadshedding which leads to lower production. Furthermore, there is a gradual switch from maize production to soy production which could increase maize prices as supply

Furthermore, the retailers warned that food security and the supply of medication are threatened.

decreases, therefore, placing upward pressure on food prices.

**Chart 5: White maize inflation has rolled over**

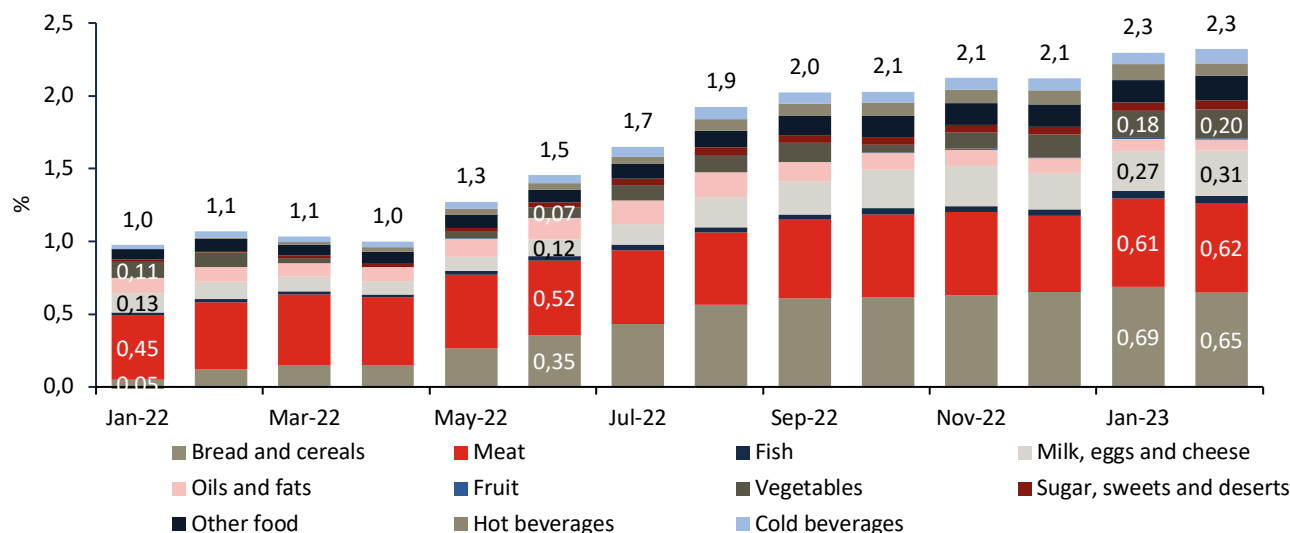


Source: IRESS, Momentum Investments

As illustrated in chart 6, the contribution of food and NAB to headline inflation has increased significantly from 1% in January 2022. Moreover, the increase has been broad-based across the food and NAB categories.

The contribution from bread and cereals increased the most from 0.05% in January 2022 to 0.65% in February 2023. This is followed by the meat category increasing from a contribution of 0.45% to 0.62% over the same period. The third largest increase is witnessed in the milk, eggs and cheese category which increased from contributing 0.13% to 0.31%. The increase in fruits has remained muted around 0% while oils and fats have decelerated from the peak of 0.17% in August 2022 to 0.08% in February 2023.

**Chart 6: Acceleration in food and NAB inflation is broad based (contribution)**



Source: Global Insight, Momentum Investments  
Data until February 2023

The increase in the price of bread and cereals has been fuelled by higher wheat prices and the depreciating rand against the US dollar. Although international wheat prices were increasing before the Russia-Ukraine war, the conflict escalated the rate of increase given supply constraints. Wheat prices increased from around US\$8.50 per bushel before the war to a high of US\$12 per bushel in March 2022. Prices have since come down to pre-war levels largely due to the Black Sea Grain initiative brokered in July 2022 which enabled a safe passage for wheat exports, among other exports, from Ukraine. Lower wheat prices had not translated to the domestic market because there is a lag between the two markets and the weaker rand exacerbated this. However, we are starting to see the impact of lower wheat prices with bread and cereals inflation decelerating to 20.5% y/y in February from 21.1% y/y in January.

The Black Sea Grain agreement was set to expire on 18 March 2023 and the initiative was extended for another 120 days on expiration day. Leading up to the expiration, Russia proposed an extension of only 60 days, half of the previous agreement of 120 days. According to Reuters, the uncertainty about Russia's commitment to this agreement pushed wheat prices up

in the third week of March which demonstrates the risk of price increases from any disruptions in the Black Sea.

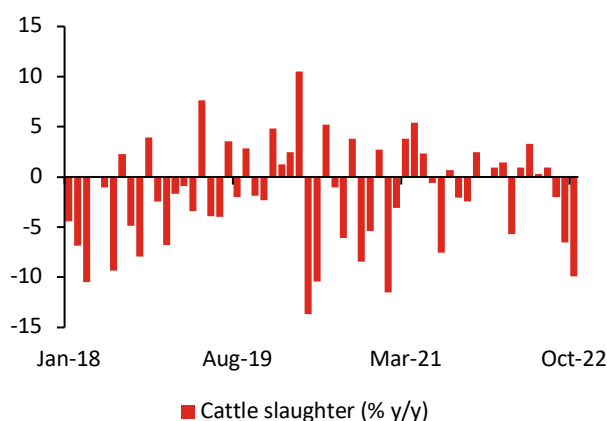
The latest 2023 summer crop estimate by the Crop Estimates Committee (CEC) forecasts an increase of 4.3% in the production of white maize compared to last year. However, yellow maize production is estimated to be 2.5% lower than last year which means total maize production is estimated to increase by only 0.9%. Nevertheless, given that SA is a large importer of wheat, the weak currency remains the biggest constraint to lower prices of bread and cereals.

The increase in meat prices during 2022 was recorded across the various meat types (beef, lamb/mutton and chicken). The only exception has been the price of pork (apart from bacon) which has remained relatively stable until the last two months of 2022. Agrimark Consulting notes that pig slaughtering was down toward the end of the year and cautions that pork prices may continue to increase in 2023. Moreover, the firm estimates that chicken prices will trend higher because loadshedding leads to ventilation disruptions and thus lower production. Meat inflation rose to 11.4% y/y in February from 11.2% y/y in January.



The foot-and-mouth disease outbreak last year mostly affected cattle hence the increase in beef prices. Moreover, cattle slaughtering plummeting from 3% y/y in May 2022 to negative 9.9% y/y in October 2022 (latest available data), as illustrated in chart 7, may have contributed to the higher prices.

**Chart 7: Cattle slaughtering plummets (% y/y)**



Source: Red meat levy admin, Momentum Investments

However, progress has been made with containing the disease and cattle slaughtering has stabilised according to Agrimark Consulting. As such, beef prices are expected to trend sideways. Moreover, price pressure on red meat will be reduced as more consumers substitute it for cheaper alternatives. Lamb prices are also expected to trend sideways.

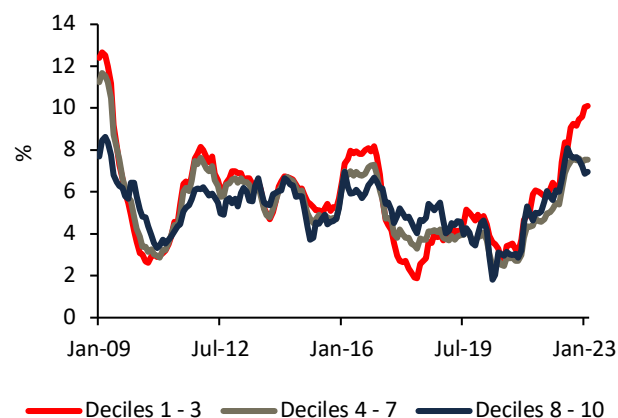
Given the upward price pressure on the two biggest contributors to food inflation (bread and cereals as well as meat), we expect food and NAB inflation to remain elevated. For most of 2022, headline inflation was driven by transport inflation. However, from December 2022, food and NAB have become the largest contributor. As such, elevated food prices will reduce the momentum of the downward trend in headline CPI.

## Short-dated inflation expectations edge higher

According to the BER, inflation expectations for 2023 increased from an average of 6.1% in the 2022 fourth-quarter survey to 6.3% in the survey conducted in the first quarter of 2023. Furthermore, the expectation for

The possibility of food inflation remaining high is a concern to the broad consumer base, especially to households in the lower expenditure deciles (deciles one to three).

**Chart 8: Deciles 1 to 3 experience double-digit headline inflation**



Source: Global Insight, Momentum Investments

Data until February 2023

Deciles one to three: up to R48 673 per annum

Deciles four to seven: R48 674 up to R143 174 per annum

Deciles eight to 10: R143 175 and more per annum

Households in the lower expenditure deciles are more vulnerable to high food inflation because a large portion of their disposable income is spent on food. As depicted in chart 8, the inflation rate of the lower expenditure deciles has crept up in a similar manner as food inflation (illustrated in chart 4), while the inflation rate for middle and high expenditure deciles has softened in line with headline inflation. This has resulted in a very wide gap relative to history between these decile groups.

The average inflation rate of deciles one to three was 10.1% y/y in February 2022. This is the highest inflation rate experienced by this group since May 2009. On the other hand, the average inflation rate for middle and high expenditure deciles was 7.5% y/y and 6.9% y/y, respectively.

average inflation in 2024 also increased from 5.6% to 5.8%. These outcomes were higher than the SA Reserve Bank's (SARB) forecast of 5.4% for 2023 and 4.8% for 2024 communicated in the January 2023 MPC forecasts.

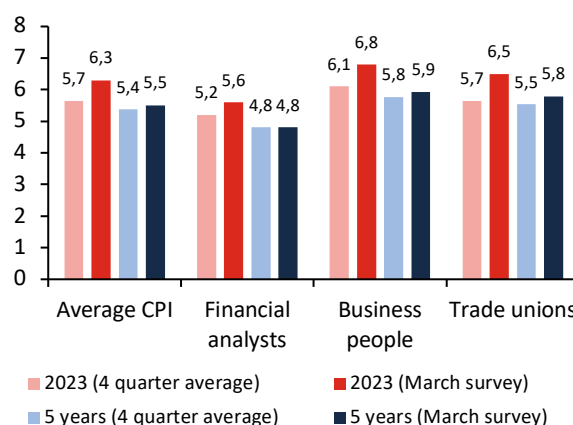
Some inflation risks have materialised so far in 2023, such as a weaker domestic currency and higher food inflation. Moreover, rand and food inflation risks remain. Higher inflation expectations are reflective of these risks and the fourth-quarter upward revision likely factors in the increase in electricity tariffs given that the previous survey was conducted before the electricity tariff was announced.

Comparing the first quarter survey results with average expectations expressed through 2022 shows an expectation of higher inflation in 2023 than what was previously expected as seen in chart 9. The higher expectation is driven by businesses (6.8% from an average of 6.1%) and trade unions (6.5% from an average of 5.7%). The higher expectation expressed by trade unions and businesses (above 6%) increases the risk of higher wage settlements and higher prices from businesses.

Longer-dated inflation expectation (five years) increased slightly from an average of 5.4% to 5.5% within the

inflation target range. The stable long-term expectation, although elevated, is encouraging because it signals that participants do not expect the prevailing risks to inflation to be persistent in the long run. This may also be interpreted as the SARB successfully communicating the intention of bringing inflation down toward the midpoint (4.5%).

**Chart 9: Inflation expectations for 2023 revised up**



Source: Global Insight, Momentum Investments

## SARB expected to hike rates

Price pressures at core level have risen more notably and the increase in services inflation points to inflation remaining sticky in the coming months. Moreover, there is a great deal of uncertainty about the direction of food inflation over the coming months. Risks to the food inflation outlook include retailers' inability to continue absorbing diesel costs especially without government intervention, the possibility of higher wheat prices, loadshedding and a weaker rand.

The SARB notes that there is a higher intolerance to inflation than interest rates and we believe they will hike rates at the upcoming MPC to address these risks. Moreover, that higher food inflation will disproportionately impact a large part of the SA population (economic deciles one to three).

We expect the SARB to hike rates by 25-basis points, but risks for a 50-basis points hike are higher than a few weeks ago given global financial instability risks following the collapse of the Silicon Valley Bank and Credit Suisse. These international developments could further weaken the rand which would put pressure on the inflation trajectory and lift inflation expectations.

Despite global financial stability risks posing a threat to the local currency and surveyed inflation expectations, we do think that real interest rates are already in meaningfully positive territory (using one-year ahead inflation expectations), particularly given the subdued outlook on trend growth. As such, this could limit the extent of interest rate hikes from here.

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