



Headline inflation falls back within the inflation target range

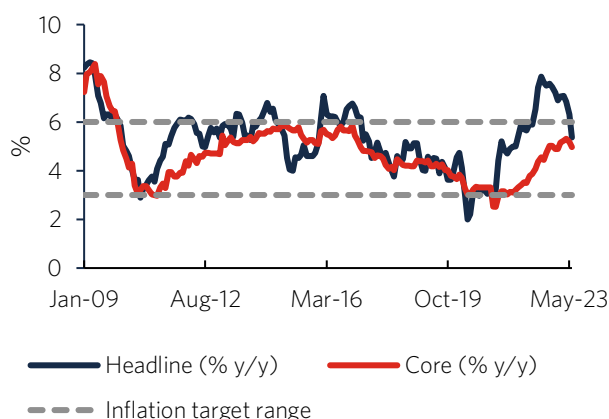
Highlights

- Statistics South Africa (Stats SA) reported headline inflation (CPI) at 5.4% year-on-year (y/y) for June 2023 from 6.3% y/y in May. This is a welcome return to the SA Reserve Bank's (SARB) inflation target range of between 3% and 6%.
- The deceleration in CPI was mainly led by a substantial drop in transport inflation (1.8% y/y, down from 7% y/y in May) and lower food and non-alcoholic beverages (NAB) inflation (11% y/y, down from 11.8% y/y in May).
- Core (underlying) inflation moderated from 5.2% y/y in May to 5.0% y/y in June, better than the Reuters median consensus of 5.1%. The drop in underlying inflation was led by a moderation in public transport as well as household contents and equipment inflation.
- The recent deceleration in producer price inflation (PPI) for food products should filter through to the retail level over the coming months. Moreover, the Food and Agriculture Organisation's (FAO) Food Price Index continued to come down in June and the Crop Estimates Committee (CEC) revised its estimate of white maize production for 2023 upward which will be supportive of lower food inflation. The expiration of the Black Sea Grain initiative introduces inflationary risks.
- The Energy Information Agency (EIA) expects rising oil demand and lower supply from oil production cuts to increase the average price of Brent crude oil from July 2023 through to December 2024. Brent crude oil is estimated to average \$79 bbl in 2023 and increase to \$84 bbl in 2024.
- The Central Energy Fund's (CEF) data suggests higher fuel prices in August. Both grades of diesel could increase by almost 50c/l, and an increase of below 10c/l is estimated for petrol (in land 95).
- Stats SA data indicates that the lower expenditure deciles (deciles one to three) are adversely impacted by the higher cost of living because they spend the bulk of their budget on food. The average inflation rate of this group was 8.4% in June, higher than headline inflation, but there has been improvement given the softer food inflation in recent months.
- Inflation expectations released by the Bureau for Economic Research (BER) in July projected a deteriorated view of short-dated inflation expectations across the three social groups.
- Despite headline inflation falling within the target range, food inflation decelerating and recent rand strength, we continue to expect one more interest rate hike of 25 basis points from the SARB tomorrow. Our expectation of a higher interest rate is informed by elevated inflation expectations which need to be anchored, renewed upside risks to international oil prices and negative risks to the rand outlook. We see the expected hike as the last one, leaving the repo peak at 8.5%.

Inflation is encouragingly rolling over

Headline inflation has been running above the upper limit of the SARB's inflation target for the past 13 months, reaching a peak of 7.8% in July 2022 as illustrated in chart 1. The June CPI print of 5.4% y/y reported by Stats SA marks the first inflation rate which falls within the target band in over a year. While prices are still elevated, the downward trend of inflation to within the target band is a move in the right direction and will be welcomed by consumers and policy makers. The June inflation outcome was the third consecutive positive inflation surprise against the Reuters median consensus (5.6% y/y).

Chart 1: Headline CPI drops into the target range



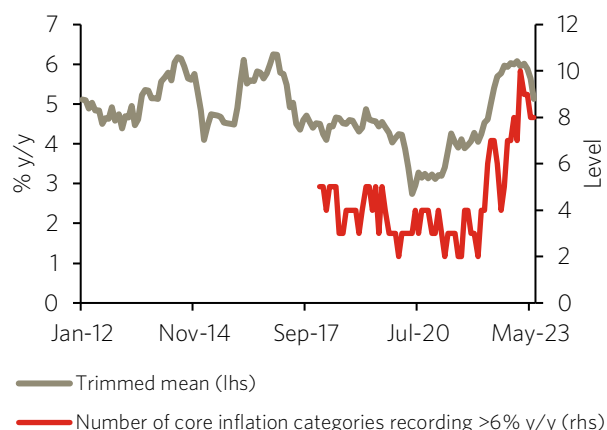
Source: Global Insight, Stats SA, Momentum Investments
Data until June 2023

Unlike headline inflation, core inflation has remained contained within the inflation target range owing to below-anticipated increases in rental costs and health insurance. Core inflation is hovering closer to the upper limit of the target band but decreased from 5.2% y/y in May to 5.0% y/y in June (Reuters median consensus: 5.1% y/y).

The number of underlying inflation categories which are recording inflation of above 6% have decreased from 10 in February 2023 to eight categories in June (see chart 2). This indicates that the underlying pressure points are narrowing. Trimmed mean (an alternative measure of underlying inflation which excludes items with the highest and lowest month-on-month (m/m) percentage changes every month) was down to 5.1%

y/y in June from 5.7% y/y in May. The downward trend from the peak of 6.1% in January 2023 further indicates that underlying pressures are softening.

Chart 2: Underlying inflation pressures are receding



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

Softer core inflation was predominantly due to the moderation in public transport (9.7% y/y from a double-digit rate of 14.2% y/y in May) as well as household contents and equipment (4.6% y/y from 5.6% y/y in May). The modest increase in rental inflation kept core inflation contained. Actual rentals and owners' equivalent rent increased by 2.7% and 2.9%, respectively.

Rental costs are surveyed once every quarter together with other categories, namely domestic workers' wages, taxi fares, train fares, and motor vehicle insurance. These items combined account for just over 21% of the inflation basket. This makes June a survey intense month but none of these items experienced substantial changes.

The gap between goods and service inflation has narrowed markedly in June. Goods inflation fell to 6.3% y/y from 8% y/y in May and service inflation was down to the midpoint from 4.6% in May. We expect headline inflation to decelerate further in the coming months supported by base effects from the escalation of goods inflation during 2022. However, the support from base effects may subside in the third quarter of 2023.

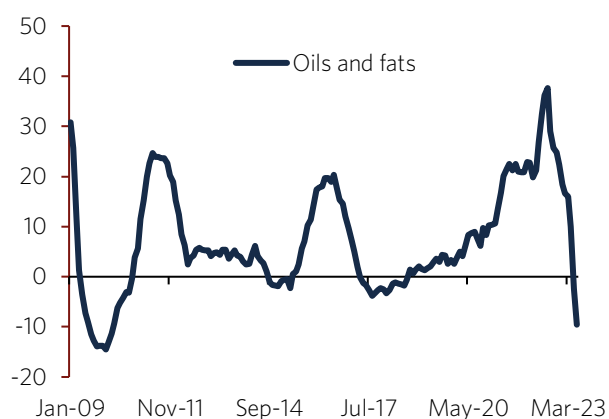
Food inflation is moving in the right direction

Food and NAB inflation dropped for the third consecutive month to 11% y/y in June, down from 11.8% in the previous month. This brought the category's contribution to headline inflation to 1.9% y/y in June (below the 2% range recorded over the past nine months).

The biggest driver of lower food and NAB inflation was the deceleration in food inflation from 12% y/y in May to 11.1% y/y in June. Five of the nine food groups recorded lower inflation rates. The prices of oils and fats declined by 9.5% y/y (see chart 3). At the Talk to the SARB Forum held in July, the governor mentioned that R100 could buy three bottles of 2l cooking oil three years ago and today consumers are struggling to get one 2l bottle of cooking oil with R100. The deflation in oils and fats will provide much needed reprieve.

Bread and cereals as well as meat inflation (the biggest components of food inflation) also softened in June. Sugar, sweets and desserts accelerated from 11.9% y/y in May to 16.4% y/y in June.

Chart 3: Oils and fats in deflation territory (% y/y)



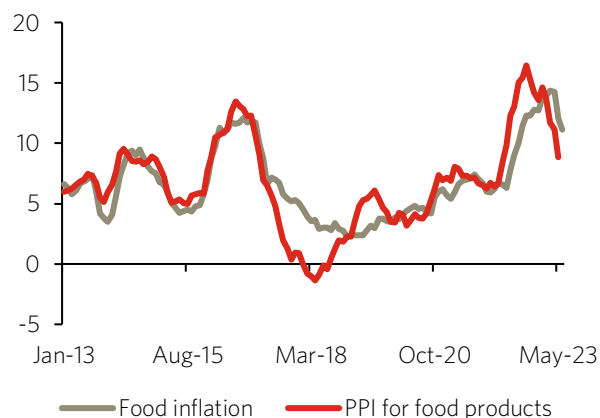
Source: Global Insight, Stats SA, Momentum Investments
Data until June 2023

Food inflation is easing in line with PPI for food products and global food inflation with a lag.

According to Stats SA, PPI for food products dropped from 11.1% y/y in April to 8.8% y/y in May. As depicted in chart 4, PPI for food products increased to levels

above that of consumer food inflation and peaked above what seems to be the peak in food inflation, which signals that food producers absorbed some of the higher costs. In April, the Agricultural Business Chamber (Agbiz) defended food producers against concerns raised by the Competition Commission that food producers may be increasing prices more than warranted. The marked drop in food producer inflation indicates that consumer food inflation may continue to come down in coming months.

Chart 4: PPI for food products points to a further deceleration in food inflation (% y/y)



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

The FAO reported a month-on-month drop of 1.4% in the nominal global Food Price Index in June, mainly led by a drop in sugar, oils and cereals. Sugar decreased for the first time in four months due to a good sugarcane harvest in Brazil and weak global import demand. The FAO notes that concerns over El Niño affecting sugarcane crops and the appreciation of the Brazilian real against the US dollar restricted price decreases. On an annual basis, the global Food Price Index was down 21% in June reflecting a significant decrease in oils (45% y/y), cereals (24% y/y) and dairy (22% y/y). Meat prices have also dropped but by a lesser degree (6.4% y/y), while sugar prices are still 30% more than a year ago.

In the June CEC release, the 2023 production forecast of commercial maize was revised up by 1.02% m/m,

with most of the increase coming from white maize. The upward revision may be partly due to less irrigation interruptions with the lower loadshedding experienced recently. Higher maize output will be supportive of the deceleration in food inflation given that maize is the most important field crop in the country and is a staple for most South Africans. Sunflower seed and sorghum production was revised down and the other field crop production estimates were unchanged.

Leading indicators (producer prices and global food prices) are clearly pointing to a further drop in food inflation over the coming months. Factors which may limit the rate of decrease include the volatile exchange rate, changes in weather conditions, the occurrence of animal diseases, and the recent expiration of the Black Sea grain deal.

News24 reported that the third outbreak of avian flu in the past three months (April to June) has been

contained so far but the SA Poultry Association (SAPA) is concerned about the possibility of more outbreaks because the flu is being spread by wild birds. While Astral Foods (SA's largest poultry producer) indicates that SA poultry farmers are more prepared for such outbreaks from past experiences (2017 and 2021), risks remain, and widespread outbreaks could affect poultry prices.

The Black Sea Grain initiative (a deal brokered in July 2022 that enabled a safe passage of grain exports from the Ukraine following Russia's invasion of Ukraine) has ended after Russia declined to extend the deal on Monday (17 July 2023). This deal was instrumental in stabilising food prices globally. As such, the end of this deal introduces risks to global food prices. *CNBC* reported that wheat, corn and soybean prices increased in the hours following Russia's decision to exit the deal.

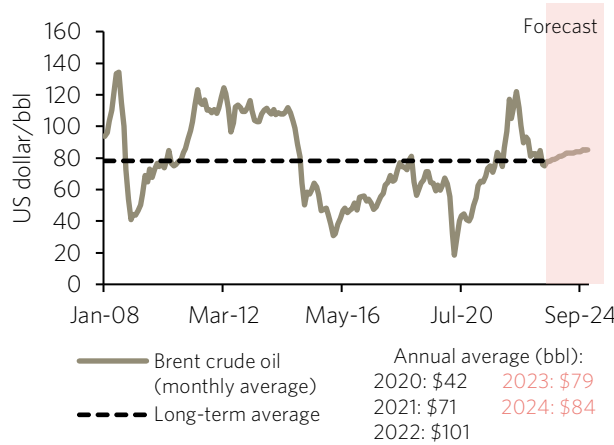
International oil prices projected to gradually trend upward in the near term

The average price of Brent crude oil continued trending down in June to US\$74.8 bbl, a slight drop of \$0.8 bbl following the sizeable drop of \$9.1 bbl in May. According to the International Energy Agency's (IEA) July Oil Market Report, crude oil prices have not ticked up so far despite the production cuts announced by the Organisation of the Petroleum Exporting Countries Plus (OPEC +) because the supply cuts have been offset by higher output from non-OPEC producers and oil demand from the reopening of China has been lower than expected so far. However, the EIA estimates a gradual upward trend in the average price of crude oil from July (\$78 bbl) until December 2024 (\$85 bbl) as depicted in chart 5. Consequently, crude oil prices are estimated to average \$79 bbl in 2023 and increase to \$84 bbl in 2024. Both years are expected to average below the highs recorded in 2022 (average of US\$101) but above pre-pandemic levels.

Following the extension of production cuts announced by Saudi Arabia in July, the IEA notes that output from the country will drop to a two-year low in July and August and Russia will overtake Saudi Arabia as the top crude producer during those months. This development

corresponds with the upward pressure on prices from July as forecasted by the EIA.

Chart 5: Brent crude oil prices estimated to tick up



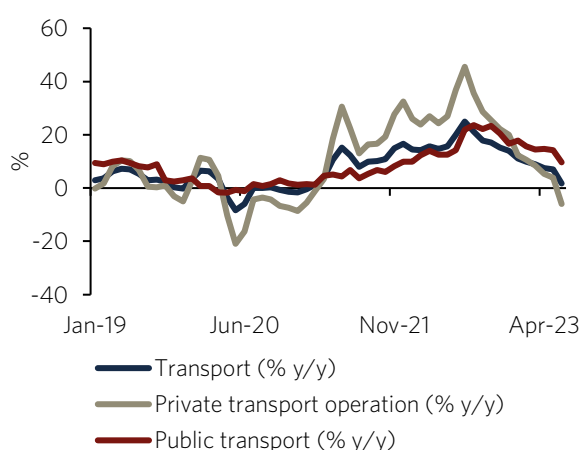
Source: Global Insight, EAI, Momentum Investments
Data until December 2024

The estimated gradual increase in crude oil prices over 2023 and next year will place renewed pressure on domestic fuel prices and transport inflation. The deceleration in transport inflation has been instrumental in easing inflationary pressure on a headline level and

this category is no longer regarded as one of the main contributors to headline inflation. However, renewed upside risks to fuel prices may stall or reverse the recent progress made depending on the extent of oil price increases as well as the movement of the exchange rate.

The rand has gained some strength against the US dollar in June, averaging R18.85/US\$ from R19.73/US\$ in May. So far in July (1 to 18 July), the average exchange rate is slightly stronger than June at R18.47/US\$. A continuation of rand appreciation will be positive for food inflation and fuel prices. However, the SARB has flagged that the exchange rate is “expected to remain volatile and sensitive to idiosyncratic shocks”.

Chart 6: Significant decline in private transport inflation (fuel)



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

In June, transport inflation fell sharply to 1.8% y/y from 7% y/y in May. Within the transport category, private transport inflation fell to negative 5.9% y/y owing to the drop in fuel prices. Private transport inflation has enjoyed significant reprieve over the past 11 months from a peak of 45.5% in July 2022 to deflation in June

2023 as illustrated in chart 6. Conversely, public transport inflation is still elevated at 9.7% y/y.

The CEF announced a drop of 24c/l and 17c/l in the price of inland petrol, 93 and 95, respectively in July. Both grades of diesel increased by just below 20 c/l in the same period. Despite the price of diesel increasing to R19.49/l in July, diesel is still R1.74/l cheaper than in January 2023. Petrol is higher than diesel at R22.46/l and R1.06/l more expensive than in January. Both petrol and diesel prices are still above pre-Russia-Ukraine war levels.

BusinessTech reports results from a study conducted by Picodi which indicate that despite the elevated prices, fuel is more affordable in SA compared to other countries. Picodi measures affordability in terms of how many litres of petrol a consumer can buy with the nation's average salary. Against this measure, SA ranked first among the nine African countries investigated in the first half of 2023. The average net salary of a South African (R21 564 per month according to Stats SA) can purchase 968 litres of petrol in 2023. This has improved from 865 litres in 2022 but is still below 1 215 litres in 2019. Globally, the countries with the highest petrol affordability are Kuwait (7 222 litres), Qatar (6 839 litres) and United Arab Emirates (4 611 litres). Cuba was the worst country where the average salary can only purchase 27 litres.

The CEF's estimated under-recovery for both grades of diesel (published on 18 July 2023) suggests a further increase of almost 50c/l in the price of diesel in August. The under recovery reported for both grades of petrol point to petrol prices increasing slightly (less than 10 c/l).

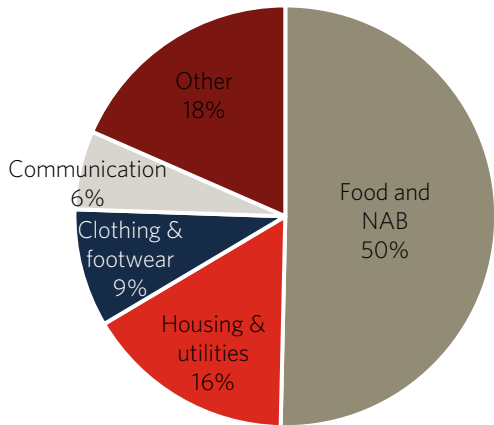
Low-income households are adversely affected by the cost-of-living crisis

Different income groups experience varying inflation rates because the composition of their consumption basket is vastly different. Stats SA reports that the poorest 10% of households (decile 1 with an annual expenditure of up to R20 140) spend half of their annual

budget on food and NAB while their second-biggest expenditure item is housing and utilities 16% (see chart 7). Therefore, two thirds of this group's annual budget is allocated toward these two categories. As such, it is not surprising that when food and NAB inflation surged to a

high of 14% in March 2023, the inflation rate of decile 1 also reached double digits (11.3%). The most vulnerable households spend the least on education (0.3%), health (1%) and transport (1%)

Chart 7: Decile 1 spends half of their budget on food and NAB

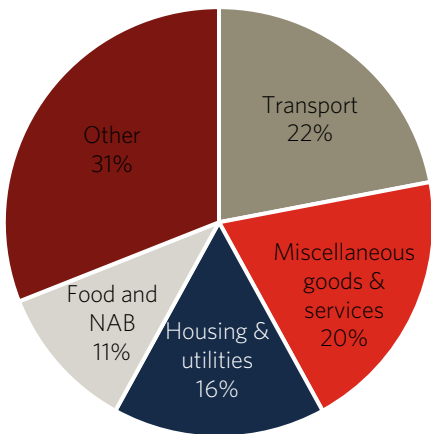


Source: Stats SA, Momentum Investments

On the other hand, the richest 10% of households (decile 10 with an annual expenditure of R312 247 and more) spend only 11% of their annual budget on food and NAB (see chart 8). This group’s expenditure is more evenly distributed, but they spend the bulk of their budget on transport (22%) and miscellaneous goods

and services (20%). Therefore, this group is disproportionately affected by changes in fuel prices and insurance premiums.

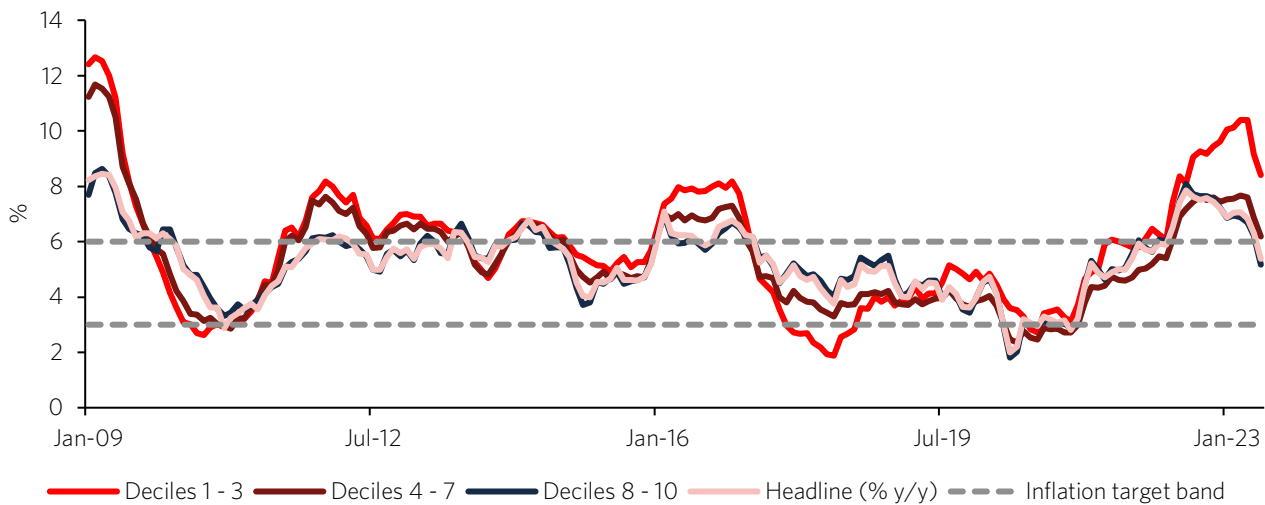
Chart 8: Decile 10 spends the bulk of their budget on transport



Source: Stats SA, Momentum Investments

Households in expenditure decile 10 spend the same proportion of their budget (16%) on housing and utilities as households in decile 1 which means changes in this category affects both groups proportionally. The richest households spend the least of their budget on health (2%) and communication (2%)

Chart 9: Poorest households hardest hit by cost-of-living crisis



Source: Global Insights, Stats SA, Momentum Investments
Data until June 2023

Stats SA further notes that decile 10 accounts for 48.71% of CPI while decile 1 accounts for only 0.48%. Consequently, the inflation rate of the higher expenditure deciles (8 to 10) closely mimics headline CPI as illustrated in chart 9. The average inflation of the top three deciles has been decelerating in line with headline CPI and was 5.2% y/y in June, slightly lower than headline inflation. Conversely, the rate of the lower expenditure deciles (1 to 3) diverged since July last year matching the trend in food and NAB inflation. The softer food and NAB over the past three months is reflected in

the sharp decrease of the average inflation experienced by the lower expenditure deciles (8.9% y/y in June from 10.4% in April 2023). Nevertheless, this groups inflation is still tracking significantly above the headline rate and the upper limit of the inflation target. This demonstrates that poorer households are adversely affected by the cost-of-living crisis. A further deceleration in food and NAB will nevertheless bring down the inflation rate of the lower income households.

SARB likely nearing the end of the hiking cycle

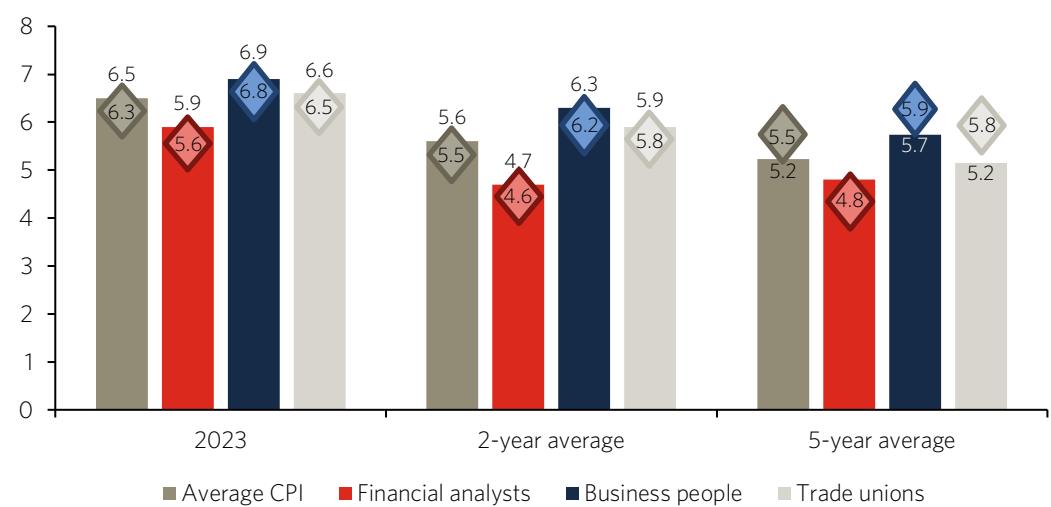
The June inflation rate falling within the target band is a great outcome for both consumers and the SARB, particularly ahead of the interest rate decision tomorrow. We expect inflation to ease further in the months ahead due to base effects and a further moderation in food inflation as signalled by the drop in the various leading indicators.

The SARB often highlights that poorer households and those with a fixed income are the most affected by higher inflation and that higher interest rates affect these groups to a lesser degree which is partly why the SARB was comfortable with hiking the repo rate to

contain the cost-of-living crisis over the past couple of months. We believe the decelerating inflation of the lower income households in recent months as well as the likelihood of this trend continuing as food inflation softens will possibly be encouraging for the Monetary Policy Committee (MPC).

Nevertheless, risks to the inflation trajectory remain, namely the volatile exchange rate, upcoming drier weather conditions, concerns over animal diseases and renewed upward pressure on international oil prices.

Chart 10: Short-dated inflation expectations deteriorated in the second quarter of 2023



Source: Global Insights, Stats SA, Momentum Investments
Diamond illustrates the results from the first quarter of 2023 survey

As illustrated in chart 10, short-dated inflation expectations (2023 and 2-year ahead) marginally deteriorated across all the respondents (analysts, businesses and labour) in the second quarter of 2023. While this will unlikely be a surprise to the MPC because there is an expectation that inflation expectations will remain high and only change direction after a couple of softer inflation prints, an increase in the repo rate could send a signal to these social groups and help anchor expectations. Encouragingly, the expectation of inflation over the next five years improved from 5.5% to 5.2%.

The SARB noted that they also need to see more inflation prints to gain more certainty of price deceleration.

Given the above considerations, we continue to expect one more interest rate hike of 25 basis points in the MPC meeting tomorrow, leaving the peak of interest rates at 8.5%. We expect the first interest rate cut to be implemented by the end of the first quarter next year at the earliest.

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