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in the moment


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# Inflation cools by more than expected to 4.7% y/y in July

## Highlights

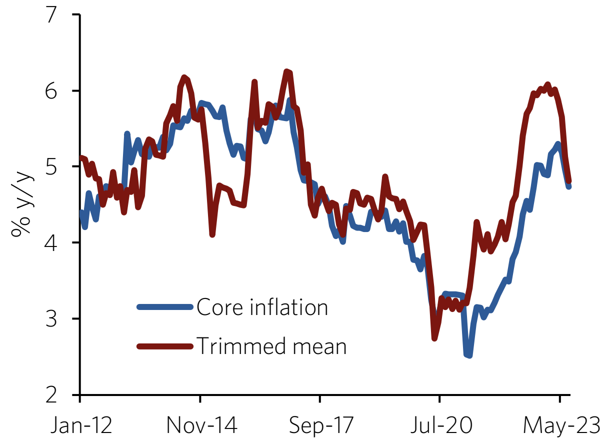
- Statistics South Africa (Stats SA) reported a notable drop in headline inflation (CPI) from 5.4% year-on-year (y/y) in June 2023 to 4.7% y/y in July. This is on the back of lower food and non-alcoholic beverages (NAB) inflation (9.9% y/y in July from 11% y/y in June) and transport inflation (negative 2.6% y/y from 1.8% y/y).
- Core inflation (underlying) also dropped to 4.7% y/y in July from 5% y/y in June due to public transport inflation plummeting from 9.7% y/y in June to 2.6% y/y in July.
- Both headline and underlying inflation outcomes surprised favourably against the Reuters median consensus of 5% y/y and 4.9% y/y, respectively.
- Domestic food inflation eased for the fourth consecutive month to 10% y/y in July from 11.1% y/y in June, in contrast to global food inflation reflected by the United Nations (UN) Food and Agriculture Organisation (FAO) index, which ticked up slightly in July. Risks to a further significant dip in food inflation largely stem from the termination of the Black Sea Grain Initiative and the recent reintroduction of tariffs on chicken imports in SA.
- The National Oceanic and Atmospheric Administration (NOAA) officially declared that we have been in the El Niño season since June 2023. According to Reuters, emerging market economies are more vulnerable to this phenomenon because food has a bigger weight in the inflation basket, agriculture contributes more meaningfully to economic growth (GDP) and employment in these economies and these countries typically have lower fiscal buffers. The Agricultural Business Chamber (Agbiz) has, however, noted a lower risk in SA if El Niño does not persist past next year.
- Water and electricity inflation were higher at 9.6% y/y and 14.9% y/y in July, respectively. This reflects the water and electricity tariff increases which came into effect on 1 July 2023.
- Transport slipped into deflation in July 2023. We may see a slight increase in August due to higher international oil prices in July and a weaker domestic exchange rate. Early data from the Central Energy Fund (CEF) suggests fuel increases of R1.60 /l for petrol (inland, 95) and R2.74 /l for diesel (inland, 0.05%) in September.
- In our view, the latest inflation figure substantiates another pause in the interest rate at the upcoming September rate decision meeting. Should unfavourable risks to the inflation outlook materialise, indicating that the SA Reserve Bank's (SARB) expectation of sustainably reaching the midpoint of the target range by the first quarter of 2025 is too optimistic, the SARB would likely react by raising interest rates marginally further. These risks include global food price uncertainty, renewed upside pressure on international oil prices, El Niño, higher administered prices, the energy crisis, logistics constraints, higher average salaries and persisting rand weakness.
- Nevertheless, taking the balance of risks to inflation and growth into account, we expect a protracted pause in interest rates and the first interest rate cut to be implemented in the second quarter of next year.

## Inflation appears to be contained relative to a year ago

The fight against inflation has progressed well from the peak of 7.8% y/y recorded a year ago in July 2022. Since then, CPI dropped into the SARB's inflation target range in June 2023 (5.4% y/y) for the first time in 13 months. Stats SA published a further drop to 4.7% y/y in July 2023, noticeably better than the Reuters median consensus of 5% y/y. This marks the fourth consecutive decrease in the inflation rate. The lower July print was primarily due to easing food and NAB inflation (9.9% y/y from 11% y/y in June, contributing 1.7 percentage points) and transport slipping into deflation at negative 2.6% y/y in July, detracting 0.4 percentage points from inflation (high base effects).

Core inflation was also lower in July (4.7% y/y) compared to 5% y/y in June and better than the Reuters median consensus of 4.9% y/y. This marks the third consecutive decrease in underlying inflation which suggests that core inflation may have peaked in April 2023. This is supported by the more apparent downward trend in the trimmed mean (an alternative measure of underlying inflation which excludes the top and bottom 10% of the basket items) as seen in chart 1.

Chart 1: Core inflation possibly peaked in April 2023

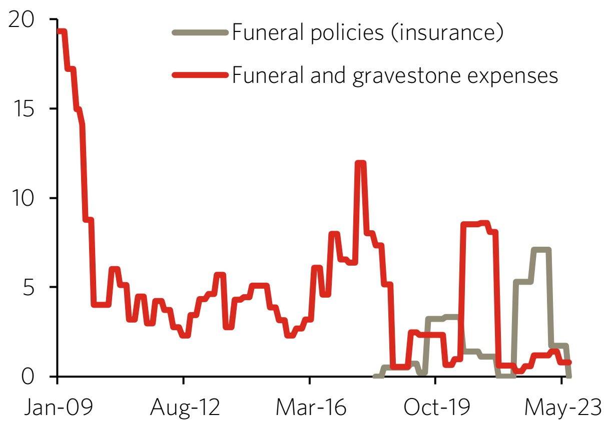



*Source: Global Insight, Stats SA, Momentum Investments*
*Data until July 2023*

Core inflation was driven down by the sizable drop in public transport inflation from 9.7% y/y in June to 2.6% y/y in July. This offset the rise in alcoholic beverages and tobacco (6.8% y/y from 6.1% y/y), health (6.2% y/y from 5.9% y/y) and vehicles (8.1% y/y from 7.6% y/y). The main elements keeping core inflation elevated are miscellaneous goods and services (mostly health insurance), vehicles as well as alcoholic beverages and tobacco.

July is not a high survey month as less than 10% of the basket is surveyed apart from the constant monthly survey items. Additional items surveyed in July include gymnasium fees, funeral expenses, funeral policies, gravestone maintenance, building insurance, household content insurance, municipal charges for water, property rates, electricity and local bus fares.

Chart 2: Funeral cost inflation remains low since COVID-19 shock, % y/y




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

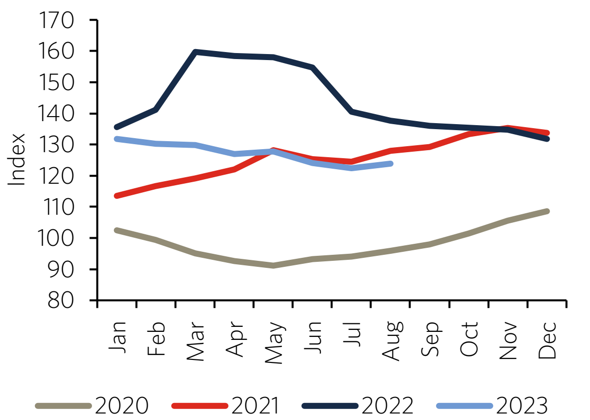
Funeral and gravestone inflation has come down considerably from the recent high of 8.6% y/y in the first quarter of 2021 to 0.8% y/y in July 2023. Funeral and gravestone inflation surged during the pandemic and dropped sharply as soon as the threat of COVID-19 dissipated (see chart 2). On the other hand, funeral policy costs shot up to a high of 7.1 y/y in the third and fourth quarters of 2022 following the pandemic but have also come down to 0% y/y in July 2023. Both indices are currently well below headline CPI and their respective long-term averages. Moreover, the resurgence of a new COVID variant (Eris) will unlikely pose a threat to higher inflation in these products.

## Food inflation is easing but upside risks are emerging

The decrease in food and NAB inflation was largely due to decelerating food inflation (10% y/y in July down from 11.1% y/y in June). Six of the nine food groups recorded lower inflation rates in July and a notable deceleration relative to June was recorded in oils and fats (negative 12.9% y/y from negative 9.5% y/y), vegetables (18.5% y/y from 20.9% y/y) and bread and cereals (13.1% y/y from 15.5% y/y).

Internationally, the FAO nominal food price index ticked up by 1.3% to 123.9 points in July (see chart 3). This was due to a sharp increase in the vegetable oils price index (12.1% to 129.8 points) following seven consecutive months of declines.

Chart 3: FAO food price index ticked up in July 2023

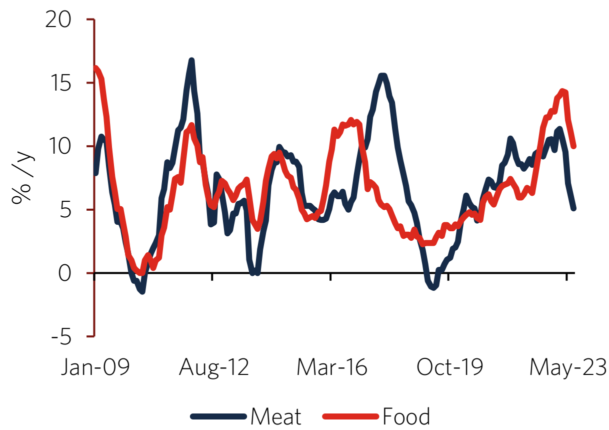



*Source: FAO, Momentum Investments*

According to the FAO, uncertainties around exports from the Black Sea region and rising world crude oil quotations drove up sunflower oil prices. Palm, soy and rapeseed oil prices were driven up by an expectation of weak production growth in the respective regions. The other food indices (dairy, meat, sugar and cereals) decreased thus offsetting the increase in vegetable oils. The cereals price index was slightly lower in July but there were pressure points stemming from the termination of the Black Sea Grain Initiative coupled with dry weather conditions, which led to an increase in wheat prices for the first time in nine months. The FAO further notes that the rice export ban imposed by India in July drove the rice price index to its highest level since September 2011. These factors introduce upside risks and could push the global food prices index back above 2021 levels.

The reintroduction of chicken import tariffs poses further upside pressure on food price inflation, especially given the weight of meat in the domestic food basket (strong correlation illustrated in chart 4). Meat is the biggest category in the food basket, accounting for 35.4% of the basket. Chicken accounts for a significant share of the meat price index (38.6%).

Chart 4: Food inflation closely mimics meat inflation given the weight of meat in the food basket




*Source: Global Insight, Stats SA, Momentum Investments*

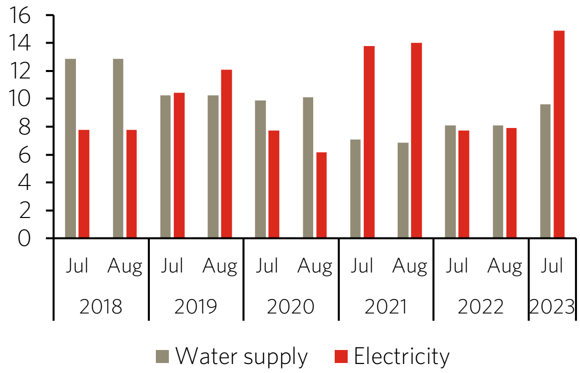
According to *News24*, trade tariffs on imported chicken were suspended in July 2022 to provide reprieve against the surge in food prices. These tariffs were reinstated in August 2023 upon findings that producers in Brazil, Denmark, Poland, Spain and US have been dumping poultry products in SA. As such, the reintroduction of the tariffs is an attempt to try and prevent dumping and protect poultry producers. Given that businesses are likely to pass on the tariff costs to consumers through price increases, these tariffs have the potential of undermining the deceleration in food inflation. DNA Economics noted that the impact of tariffs is regressive which means the lower income-decile households will be adversely affected by these measures as they spend the bulk of their income on food.

## Electricity prices, El Niño and international oil prices present risks to the inflation outlook

While inflation has been softening over the past couple of months, the energy crisis is putting upward pressure on electricity prices and may continue to do so in the near term. Moreover, the risk of drier weather conditions has gained momentum and oil supply cuts threaten the moderation in price increases.

Electricity inflation (surveyed twice a year) was 14.9% y/y in July 2023, up from 7.9% y/y since the last survey in August 2022 as seen in chart 5. This is reflective of the 18.65% electricity tariff which was approved by the National Energy Regulator of SA (NERSA) in March 2023 but effective 1 April 2023 for Eskom's direct customers (non-municipal customers). Eskom notes that municipalities were subject to a revised increase of 15.1% (previously 18.49%) effective 1 July 2023. The lower rate increase for municipal customers will provide some reprieve for households but it is still above inflation. The SARB's forecast for electricity prices is 13.4% for 2024 is expected to moderate to 10.9% in 2025.

### Chart 5: Nersa tariff behind the uptick in electricity inflation, % y/y




*Source: Global Insight, Stats SA, Momentum Investments*

Water inflation rose to 9.6% y/y in July 2023 from 8.1% y/y in August 2022. This outcome incorporates Rand Water's above-inflation tariff increase of 9.2% effective 1 July 2023. Apart from electricity and water tariffs, households are also faced with increases in property rates, sanitation and refuse removal. See table 1 for a summary of tariff increases across some of the municipalities compared to increases implemented last year. Municipal services accounted for 15.1% of the CPI print in July 2023.

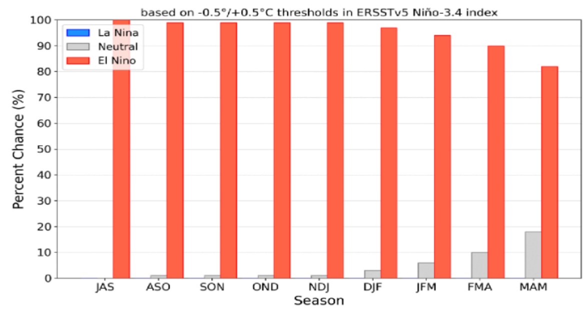
### Table 1: Municipal tariff increases for 2023-24 higher than 2022-23(%)*

| Municipality | Rates | Water | Sanitation | Electricity | Refuse removal |
|---|---|---|---|---|---|
| City of Joburg | 2 (4.85) | 9.3 (9.75) | 9.3 (9.75) | 14.97 (7.47) | 7 (5) |
| Tshwane* | 5 (6) | 9.2 (9) | 9.2 (9) | 15.1 (7.47) | 6 |
| eThekwini | 7.9 (0) | 14.9 (5.9) | 10.9 (5.9) | 18.49 (7.47) | 6.9 (4.5) |
| City of Cape Town | -1.1 (5.2) | 8.6 (6.5) | 8.6 (6.5) | 17.6 (9.5) | 5.5 (5) |
| Ekurhuleni | 4.4 (0) | 12 (11) | 5.3 (11) | 14.98 (9.61) | 5.3 (7) |
| Nelson Mandela Bay** | 5 (5) | 6 (5) | 6 (5) | 15.1 (9.4) | 6 (5) |
| Mangaung | 5.72 (3.89) | 9.8 (7.75) | 5.7 (2.4) | 15.1 (10.39) | 8 (12.97) |

*Sources: Respective metros' websites, Momentum Investments*
*Tariffs for 2022-23 are in brackets*
*Red = rates above 6%*

In June 2023, the NOAA officially declared that "El Niño is here". The agency states that there is a 95% chance that El Niño will persist through December 2023 to February 2024 and the probability decreases thereafter (see chart 6). The June 2023 to February 2024 period is within the nine to 12 months that NOAA says El Niño typically lasts, but they note that the episodes of El Niño can sometimes last for longer.

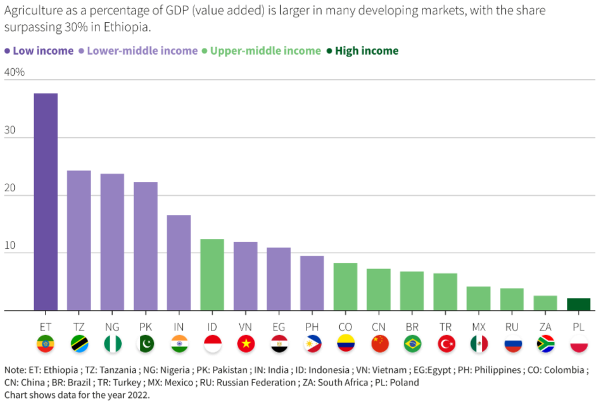
### Chart 6: Official NOAA El Nino Probabilities




*Source: NOAA*
*Probabilities as at 10 August 2023 for the Nino 3.4 sea surface temperature index*

Reuters states that emerging markets are more vulnerable to El Niño because food has a relatively bigger weight in the inflation basket, agriculture contributes meaningfully to GDP and employment in these economies and these countries typically have lower fiscal buffers. However, Agbiz has previously noted that the impact on SA's agriculture will be limited if it does not persist past 2024 due to the good soil conditions. Reuters also notes that SA is among the least vulnerable countries alongside Chile, as well as some developed countries, including Germany and US. As seen in chart 7, SA's direct reliance on agriculture is lower relative to other emerging markets.

### Chart 7: SA's direct reliance on agriculture is relatively lower




*Source: Reuters*

Reuters states that the countries that are most vulnerable include India and Egypt and the products listed as high risk include rice, cocoa, sugar and coffee.

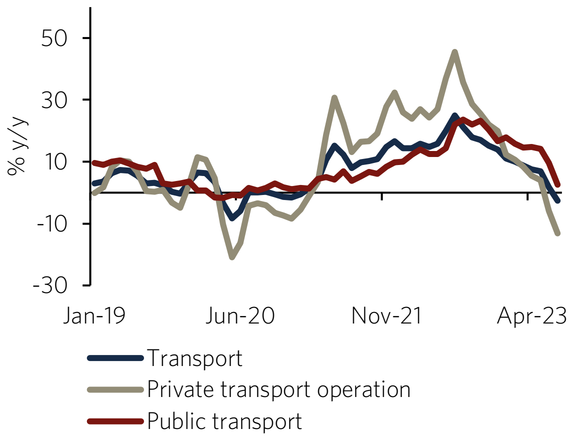
The direct impact of El Niño on SA may be limited but we are not completely shielded because of our exposure to the global economy. According to the European Central Bank (ECB), "a one-degree temperature increase during El Niño has historically raised global food inflation by more than 6% after one year".

In the August Oil Market Report, the International Energy Agency (IEA) reported that oil demand reached record highs in June and August driven by strong air travel, larger oil usage in power generation and an increase in China's petrochemical activity. On the other hand, oil supply decreased to a near two-year low in July due to the production cuts implemented by Saudi Arabia. As a result, the price of Brent Crude oil rose by 7% to $80.1 bbl in July from $74.8 bbl in June. According to the CEF, the price of petrol increased by R37 c/l and diesel increased by R72 c/l in August due to the higher international oil prices. The increase in August fuel prices was, however, cushioned by the rand appreciation against the US dollar. The rand closed at R17.88 against the US dollar in July compared to R18.85 in June.

The weaker rand in August thus far as well as early data from the CEF point to a bigger increase in fuel prices for September. Reuters partly attributes the depreciation of the rand in August to rising concerns about China's economic growth. The CEF's under recovery on 22 August is estimated at R1.60 /l for petrol (inland, 95) and R2.74 /l for diesel (inland, 0.05%). The rand is currently weaker than in July and closed at R18.79 against the US dollar on 22 August.

As it stands, the August fuel price developments and potential fuel increases in September have the potential to reverse the moderation of transport inflation. Transport inflation dropped to negative 2.6% y/y largely driven by private transport (mostly fuel) moving further into deflation territory at negative 13.1% y/y. Public transport also recorded a sizable decrease from 9.7% y/y in June to 2.6% y/y in July.

### Chart 8: Transport slips into deflation

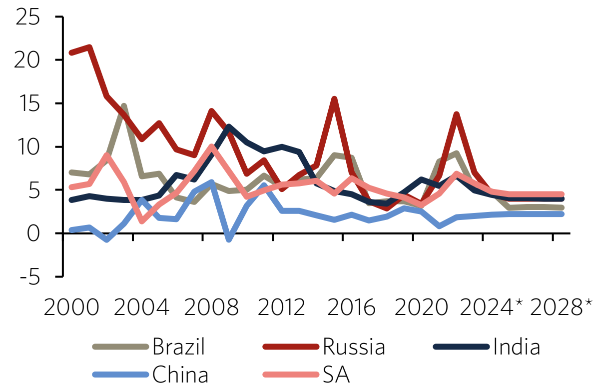



*Source: Global Insight, Stats SA, Momentum Investments*

## India currently has the highest inflation rate going into the 15th BRICS summit

Russia's annual inflation rate has typically been above that of the other BRICS nations between 2000 and 2022 as seen in chart 9. Over this period, Russia has experienced four high peaks, namely, 2001 (21.48%), 2008 (14.11%), 2015 (15.53%) and the more recent war induced peak of 13.77% in 2022. Consequently, the country has the highest average inflation rate of 10.9% (2000 to 2022) within this bloc of emerging markets. In contrast, China has experienced relatively low and more stable inflation averaging 2.17% since 2000 to 2022 and is the only country in BRICS to record annual deflation (a drop in general price levels). Of the remaining three nations, SA has the lower average inflation of 5.48% and Brazil and India are similar at 6.43% and 6.23%, respectively.

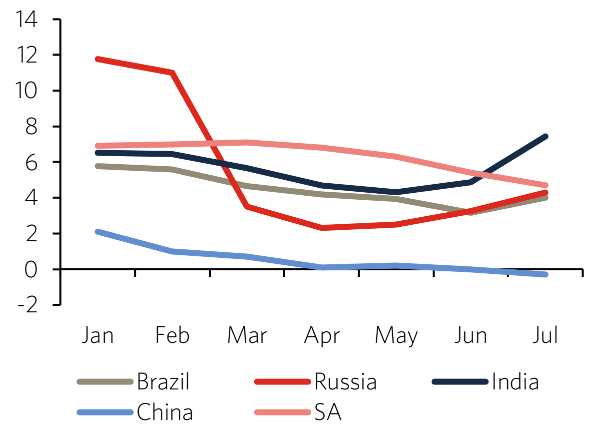
Chart 9: BRICS inflation since 2000, % y/y




*Source: Statista, Momentum*
**2023 to 2028 are forecasts*

Apart from China that benefitted from extended COVID lockdowns, the inflation rate of the other four BRICS countries shot up due to pandemic supply chain disruptions which were exacerbated by Russia's invasion of Ukraine. Each country's annual inflation rate has subsided from the respective peaks but remains above central bank inflation targets of 3% to 6% for SA, Brazil's 3.25% for 2023 and 4% for Russia and India. According to IMF forecasts, SA is expected to fall back into the inflation target range in 2023, Brazil and Russia in 2025 and India in 2027.

Chart 10: China slipped into deflation in July, % y/y




*Source: Bloomberg, Momentum*

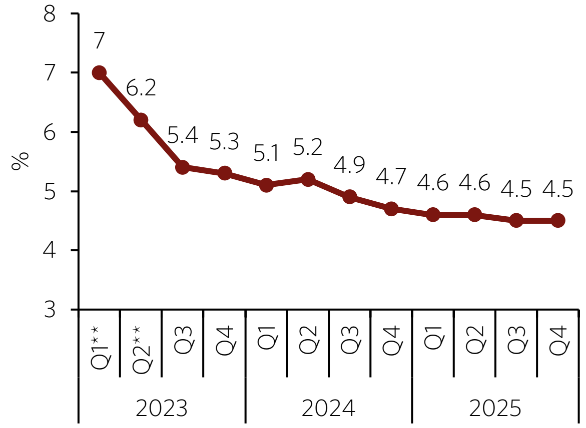
On a year-to-date (January to July 2023) basis, Russia's inflation rate was the highest in the bloc at 11.8% y/y in January. A combination of tighter monetary policy, weaker demand, base effects and a stronger currency led to inflation falling to 2.31% y/y in April (below the inflation target of 4% and the lowest rate since February 2022) but their inflation rate has been gradually ticking up since April and was 4.3% y/y in July. The highest inflation rate within the bloc is currently experienced by India (7.4% y/y in July from 4.9% y/y in June). According to the World Economic Forum, the sharp rise in July was unexcepted and largely driven by food prices. Unlike Russia, India has not fallen back to within the 4% target since September 2019. The moderation in SA's inflation rate has been slower from 6.9% y/y in January to 4.7% y/y in July but the milestone of falling within the target range of 3% to 6% was reached in June. A constant is that China's inflation rate has continued to be the lowest of these countries. China's inflation rate has eased from 2.1% y/y in January despite the economy reopening in January 2023 and the country slipped into deflation in July partly due to weak demand and the oversupply of pork prices which led to a significant drop in pork prices (26% y/y).

## SARB likely at the end of the hiking cycle but another hike is possible if upside risks persist

In our view, the latest inflation figure substantiates another pause in the interest rate at the upcoming September rate decision meeting. Should unfavourable risks to the inflation outlook materialise, indicating that the SARB's expectation of sustainably reaching the midpoint of the target range by the first quarter of 2025 is too optimistic, the SARB would likely react by raising interest rates marginally further. These risks include global food price uncertainty (on the back of the termination of the Black Sea Grain initiative, rice supply cuts from India and drier weather conditions in parts of the globe due to El Niño), renewed upside pressure on international oil prices due to supply cuts, higher administered prices, the energy crisis, logistics constraints, higher average salaries and persisting rand weakness, which pose a risk to inflation expectations.

Even if we have seen the end of the interest rate hiking cycle, significant upside risks to the inflation outlook suggest that we should see a protracted pause in interest rates and the first interest rate cut to be implemented in the second quarter of 2024.

Chart 11: SARB's forecasted inflation trajectory*




*Source: SARB, Momentum*

* *Forecasts from the July 2023 MPC*

** *Q1 and Q2 2023 are actual outcomes*