momentum investments

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in the moment

Food inflation dip drives headline figure lower to 5.3% in March

Highlights

- According to Statistics South Africa (Stats SA), annual consumer price inflation eased to 5.3% year-on-year (y/y) in March 2024 from 5.6% y/y in February. The moderation in inflation was largely attributable to lower food and non-alcoholic beverages (NAB) inflation (5.1% y/y in March from 6.1% y/y in February).
- Housing costs (accounting for 16.5% of the inflation basket) remained contained and close to the lower limit of the inflation target range (3% to 6%). Limited housing cost pressures point to contained demand-pull inflation.
- Transport inflation surprised positively, easing by 0.1 percentage point to 5.3% y/y in March. The positive surprise was due to public transport disinflation offsetting the price pressure from fuel inflation. The implemented fuel price increases in April are expected to place upward pressure on transport inflation in the next month, albeit minimal. So far, data published by the Central Energy Fund (CEF) points to a small increase of R0.34/l in petrol (95 ULP) prices for May.
- According to Bloomberg data, the price of Brent crude oil breached the US$90/bbl mark in the first two weeks of April due to fears of escalating geopolitical tensions. According to *The Guardian*, the recent Iran attack on Israel did not affect the oil supply and is not expected to morph into a bigger war. Nevertheless, risks remain.
- Food inflation has moderated sharply from a peak of 14.4% y/y a year ago to 4.9% y/y in March 2024. The SA Reserve Bank (SARB) expects food inflation to moderate to 5.5% in 2024 from 10.7% in 2023. However, we note that the estimated food inflation for 2024 could have been lower in the absence of more intense El Niño conditions. The impact of El Niño is expected to filter through to consumer prices in the second half of this year.
- The proposed above-inflation electricity and water tariff increases by some of the municipalities present upward pressure on administered price inflation in the coming months.
- Given lingering inflation risks (geopolitical tensions, worse-than-expected weather conditions), we expect the SARB to err on the side of caution as the Monetary Policy Committee (MPC) debates the interest rate trajectory going forward.
- Anticipating the SARB to maintain interest rates at 8.25% in May and only cutting in the third quarter of 2024, we acknowledge increased risks to an even more delayed interest rate-cutting cycle due to global and local developments affecting inflation expectations and recent global central bank rhetoric, warning against the risks of a potential policy error associated with premature easing. While we continue to pencil in four interest rate cuts, in the cycle, of 25 basis points each between this year and next, there are still notable risks to a later and even shallower interest rate cutting cycle.

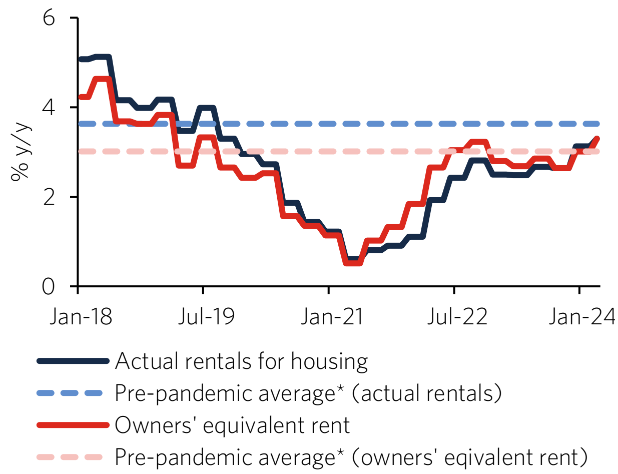
Demand-pull inflation remains contained

As reported by Stats SA, headline inflation moderated to 5.3% y/y in March 2024 from 5.6% y/y in February. Seven of the 12 main categories decelerated and four categories accelerated. The biggest upward pressure on headline inflation stemmed from education (surveyed annually in March). Education inflation rose from 5.7% y/y in February to 6.3% y/y in March. Two of the three sub-components of education accelerated in March. The sharpest increase was recorded for secondary education (7.8% y/y, previously 5.8% y/y), followed by tertiary education (5.9% y/y, previously 5.3% y/y). Primary education inflation decelerated to 5.9% y/y from 6.3% y/y.

The upward pressure from education costs was overshadowed by a meaningful decline in food and NAB (5.1% y/y in March from 6.1% y/y in February); restaurants and hotels (5.7% y/y from 6.6% y/y); household contents and equipment (1.8% y/y from 2.5% y/y) as well as recreation and culture (2.7% y/y from 3.3% y/y).

Headline inflation eased in March despite it being a high survey month (almost a quarter of the inflation basket is surveyed in addition to normal monthly surveyed items). These additional items are owners' equivalent rent (weight: 12.99%), actual rentals for housing (weight: 3.5%), school and university tuition fees (weight: 2.62%), domestic workers' wages (weight: 2.53%), taxi, train and local bus fares (weight: 1.79%), motor vehicle insurance (weight: 0.64%), crèche fees (weight: 0.38%), toll fees (weight: 0.09%) and university boarding fees (weight: 0.05%). Education components are the only categories that registered notable price changes.

Chart 1: Limited rental pressures



Source: Global Insight, Stats SA, Momentum Investments
** Pre-pandemic average refers to 2019 average*
Data until March 2024

Housing costs remained contained in March relative to historical levels (see chart 1). Owners' equivalent rent was up 3.3% y/y in March from 3.0% y/y in the previous month and actual rentals were up 3.3% y/y from 3.1% y/y over the same period. Both these indicators remained around the lower limit of the inflation target band and actual rentals inflation was still below pre-pandemic levels. This points to contained demand-pull inflation in the economy.

Core inflation eased slightly to 4.9% y/y in March from 5% y/y in February.

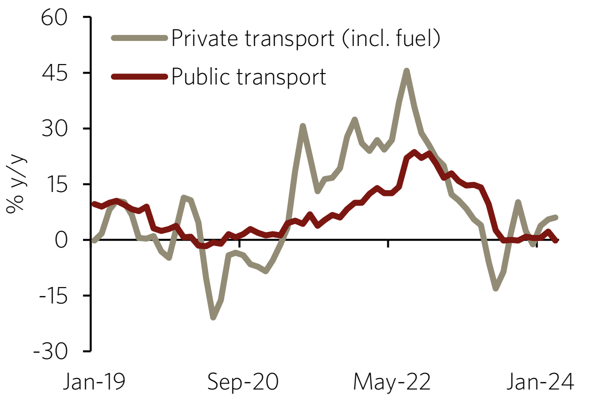
The gap between goods and services inflation narrowed further in March with goods inflation at 5.7% y/y (previously 6.2% y/y) and services inflation at 5% y/y (previously 4.9% y/y).

Public transport disinflation offset upward pressure from fuel price increases

Against our expectations, transport inflation dropped to 5.3% y/y in March from 5.4% y/y in February. We had anticipated higher transport inflation due to the large increase in fuel prices implemented in March (R1.21/l for both grades of petrol and R1.06/l for diesel (0.05%)). A more in-depth analysis of transport inflation shows that higher fuel prices did indeed result in upward inflationary pressure (private transport inflation which largely comprises of fuel rose to 6.1% y/y in March from 5.5% y/y in February). However, this was more than offset by public transport falling into deflation (negative 0.2% y/y in March from 2.2% y/y in February) as seen in chart 2.

Fuel prices were higher in March on account of higher international oil prices (US$85.41/bbl in February relative to US$83.48/bbl in the previous month) and a weaker rand which averaged R19.01/US$ in February compared to R18.78/US$ in January.

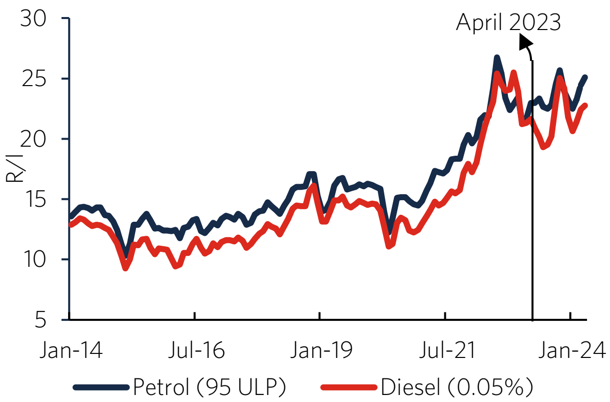
Chart 2: Public transport inflation falls into deflation territory



Source: Iress, Stats SA, Momentum Investments
Data until March 2024

The average price of Brent crude oil ticked up for the third consecutive month to US$85.41/bbl in March 2024. Compared to March 2023, Brent crude oil was 8.9% more expensive y/y. Similarly, fuel prices increased for the third consecutive month in April 2024 which indicates further upside pressure in next month's inflation print. The CEF announced a R0.65/l increase in the price of petrol (95 ULP), lifting the price of petrol to just above R25/l (9.3% more than in April 2023). Diesel (0.05%) increased by R0.32/l in April 2024 and was 8.9% more than a year ago (see chart 3).

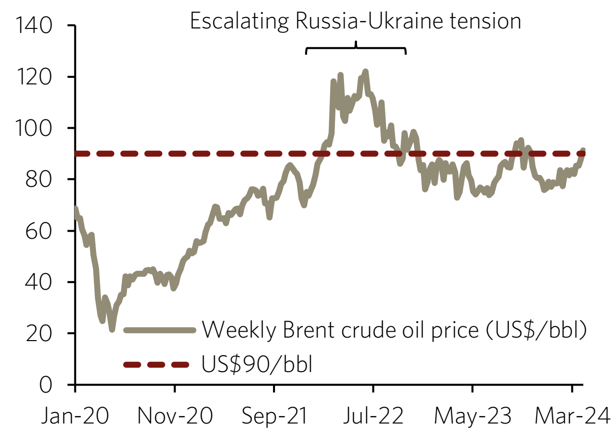
Chart 3: Fuel prices are elevated



Source: CEF, Momentum Investments
Data until March 2024

The price of Brent crude oil rallied and breached the US$90/bbl mark in the first two weeks of April 2024. The last time oil prices breached US$90/bbl was in October 2023 (see chart 4). Higher oil prices have been driven by fears of escalating tensions in the Middle East. During the second weekend of April 2024, Iran attacked Israel. However, *The Guardian* notes that the attack has not affected the oil supply which explains why oil prices have been moving sideways since the attack. There is a risk, albeit small, that Israel's response (if at all) could escalate the war and impact oil prices. It is reported that Israeli officials want to respond but do not want a major conflict with Iran especially given ongoing tensions with Gaza.

Chart 4: Brent crude oil prices breached US$90/bbl



Source: Bloomberg, Momentum Investments
Data until the week ending 12 April 2024

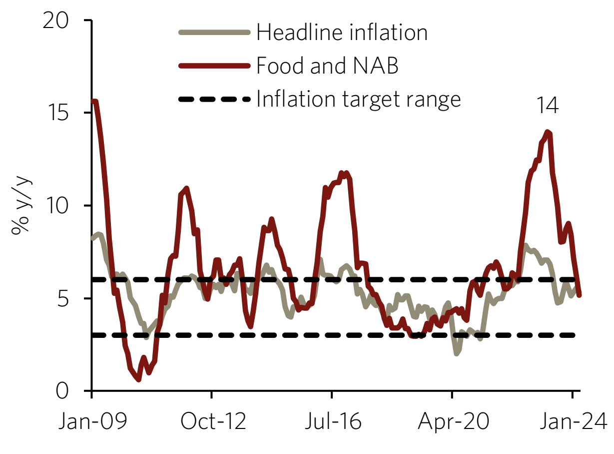
Elevated oil prices point to continued upward pressure on domestic fuel prices in May. So far, the rand is slightly stronger on a month-to-date basis compared to the same period a month ago which means that the exchange rate is not placing upward pressure yet. Fears about inflation in the United States (US) and the recent higher US inflation expectations weigh down on the rand (i.e. make it weaker). Further factors depressing the rand are a stronger US dollar on the back of better US growth and geopolitical risks bidding up safe haven assets. According to early data from the CEF (released on 16 April), we can expect the price of petrol (95 ULP) to increase by R0.34/l in May. On the other hand, diesel (0.05%) is expected to decrease by R0.24/l in May.

In the April Short-Term Energy Outlook, the Energy Information Administration (EIA) revised its average oil price forecast for the second quarter up once again to US$90/bbl (previously US$88/bbl). The agency attributes the upward revision to "strong global inventory draws and ongoing geopolitical risks". According to the *Financial Times,* the tight oil market is expected to continue through the second half of 2024 even if political tensions ease. This is because of the extension of oil supply restrictions implemented by the Organisation of the Petroleum Exporting Countries (OPEC+) and the likelihood of higher demand due to economic growth in the US, Europe and China.
The SARB has previously noted that oil prices would be more of a concern for the SA inflation outlook once they are in the range of US$96/bbl and US$100/bbl. According to the March forecasts, the SARB expects Brent crude oil to be contained at an average of US$82/bbl in 2024 (unchanged from the January projection).

Base effects support lower food and NAB inflation

Food and NAB inflation eased for the fourth consecutive month to 5.1% y/y in March (one percentage point drop compared to February). This marks the first month of food and NAB being within the inflation target band in almost two years and is significant progress from the peak of 14% y/y a year ago. Furthermore, food and NAB inflation is now tracking closer to headline inflation (see chart 5). The contribution of food and NAB inflation to headline inflation decreased to 0.9 percentage points compared to 1.1 percentage points in February and 2.4 percentage points a year ago.

Chart 5: Food inflation back within the target range



Source: Global Insight, Stats SA, Momentum Investments
Data until March 2024

The moderation in food and NAB was driven by food inflation. Food inflation dropped sharply to 4.9% y/y in March from 6% y/y in February. NAB inflation was unchanged at 7.5% y/y. Food inflation falling below 5% a year from the peak of 14.4% is a noteworthy milestone. Decelerating food inflation in March was broad-based with seven of the nine food categories recording a lower inflation rate. Fruits (3.3% y/y in March from 5.9% y/y in February) and vegetables (6% y/y from 9.4%) recorded the biggest drop followed by milk, eggs and cheese. The two biggest food categories (bread and cereals as well as meat) also moderated in March.

Drier and hotter weather conditions in February and March remain a risk to food inflation. However, the impact is expected to be felt in the second half of the year given the lag between agricultural food prices and food inflation at a consumer level. In the March MPC, the SARB revised its food inflation forecast for the third and fourth quarters up to 5.6% (previously 5.4%) and 4.8% (previously 4.3%), respectively. Nevertheless, food inflation is expected to be lower at 5.5% in 2024 relative to 10.7% in 2023.

Following seven consecutive months of moderation, the Food and Agriculture Organisation (FAO) Food Price Index rose by 1.1% month-on-month (m/m) in March. The increase was due to higher meat, dairy and oil prices. Sugar and cereal price indices were lower. On a year-on-year basis, the FAO Food Price Index was 7.7% lower than in March 2024.

Administered price inflation poses upward inflationary pressure in the near term

Some of the major municipalities in SA have announced above inflation increases for 2024/25 (consolidated by *BusinessTech* in Table 1). Notably, eThekwini and Nelson Mandela Bay have proposed electricity rate increases that are above the National Energy Regulator of South Africa (NERSA) approved rate of 12.72%. On the other hand, the City of Johannesburg and the City of Cape Town's proposed electricity hikes are below the rate approved by NERSA. eThekwini currently has the highest rate increases across the different services, like last year. *BusinessTech* reported that the "eThekwini Ratepayers' and Residents' Association (ERRA) has asked ratepayers and residents to reject the increases amid dismal services and failing infrastructure". Increasing municipal rates amid inadequate and inconsistent service delivery increases the likelihood of service delivery protests.

Table 1: Proposed municipal rate increases for 2024/25*, %

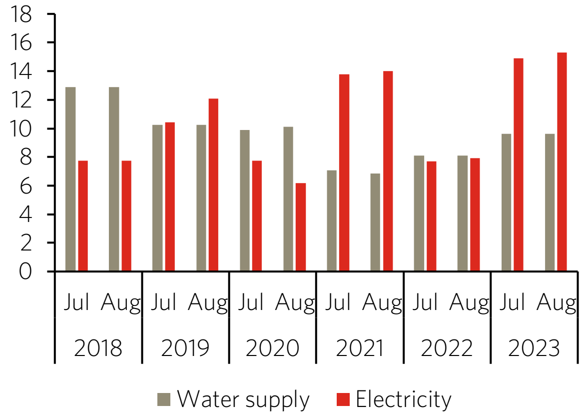
Municipality	Property rates	Electricity	Water	Sanitation	Refuse
City of Johannesburg	4.8	10.7	7.7	7.7	5.9
eThekwini	7.9	14	14.9	12.9	8
City of Cape Town	5.7	11.8	6.8	6.8	5.7
Nelson Mandela Bay	5	15.7	6	6	6

Source: BusinessTech, Momentum Investments

** Proposed for 1 July 2024*

The proposed municipal rate increases pose upward pressure on inflation in the coming months. As usual, municipal charges for water, property tax and electricity are scheduled to be surveyed in July and August 2024. However, the inflationary impact will likely be less than last year on the basis that most of the proposed hikes are less than the rate increases implemented last year, especially for electricity. Electricity inflation spiked in 2023 (see chart 6) on the back of a higher approved electricity tariff of 18.65% for 2023/24.

Chart 6: Electricity inflation spiked in 2023, %



Source: BusinessTech, Momentum Investments

The SARB often flags high administered prices as a risk to the inflation trajectory. In the March 2024 MPC statement, lowering administered prices was cited among factors needed to improve economic conditions. This signals that high administered prices are still a concern. According to a working paper published by the SARB in 2022, administered price inflation follows the trend of headline inflation (i.e. lower headline inflation results in lower administered price inflation). This means administered price inflation would benefit from lower trend inflation induced by a lower inflation target.

SA policy rates expected to remain restrictive given upside risks to inflation

The deceleration in headline inflation in March is welcome. However, the bumpy path towards anchoring inflation at the 4.5% midpoint is a concern especially given lingering inflation risks stemming from geopolitical tensions, weather conditions and administered prices to name a few.

In the April 2024 World Economic Outlook, the International Monetary Fund highlighted that "geopolitical shocks could complicate the ongoing disinflation process and delay central bank policy easing". This also applies to SA especially through the channel of higher international oil prices given SA's reliance on international oil. Upward pressure on fuel costs (from higher oil prices) could have second-round effects that lead to increased food inflation. Further pressure on food prices in addition to the expected uptick from El Niño could reverse some of the gains achieved in bringing down food inflation.

Encouragingly, the March inflation print signals little demand-pull inflation with core inflation easing.

We expect the SARB to err on the side of caution as the MPC debates the interest rate trajectory going forward. This is to ensure that inflation risks are contained.

Anticipating the SARB to maintain interest rates at 8.25% in May and only cutting in the third quarter of 2024, we acknowledge increased risks to an even more delayed interest rate-cutting cycle due to global and local developments affecting inflation expectations and recent global central bank rhetoric, warning against the risks of a potential policy error associated with premature easing. While we continue to pencil in four interest rate cuts, in the cycle, of 25 basis points each between this year and next, there are still notable risks to a later and even shallower interest rate cutting cycle.