



Surprising inflation spike to 5.9% y/y in October led by higher fuel and food prices

Highlights

- Statistics South Africa (Stats SA) published a jump in the headline rate of inflation to 5.9% year-on-year (y/y) in October 2023 from 5.4% y/y in September. The main contributors were food and non-alcoholic beverages (NAB), housing and utilities as well as transport.
- The acceleration of transport inflation was anticipated but the rate of 7.4% y/y was above expectations. Food inflation climbing to 8.8% y/y after six months of moderation was unexpected and is a potential risk to the inflation trajectory.
- Core inflation (which excludes fuel, food and energy prices) dropped to 4.4% y/y in October, slightly down from 4.5% y/y recorded in September.
- According to the Central Energy Fund (CEF), the price of both grades of petrol dropped by R1.78/l and by R0.85/l for diesel (0.05%) in November after two consecutive months of large price hikes. Early data suggests a further drop of approximately R1.08/l for petrol (inland 95) and R2.23/l for diesel (inland 0.05%) in December. This is anticipated to reduce the inflation rate for households, particularly those in the upper expenditure deciles that have a higher transport weighting in their respective consumer baskets.
- Brent crude oil averaged US\$90.8/bbl in October, lower than the Energy Information Administration's (EIA) forecast of US\$93/bbl and the actual price of US\$93.7 bbl in September. This is despite the ongoing Israel-Gaza war.
- In a *Cape Business News* article, the chief executive officer (CEO) of the SA Poultry Association (SAPA) alleviated fears surrounding the Avian flu outbreak by stating that despite the shortages and price increase of eggs as well as the expected shortages of chicken meat, it is not a crisis and preventative measures have been applied.
- As published by the Crop Estimates Committee (CEC), producers intend to plant 4.5 million hectares of summer crops in 2024, representing a 2.9% increase from 2023 and a 1.7% increase from the total planted area in 2022. The larger area intentions for 2024 expressed for the various crops are, to an extent, reversing the decreases implemented in 2023.
- Global food prices proxied by the United Nations (UN) Food and Agricultural Organisation (FAO) Food Price Index decreased slightly in October 2023 on a month-on-month (m/m) basis.
- Although October's inflation print exceeded expectations, we expect the blip to be temporary with lower fuel inflation driving down the headline figure in the coming releases. Together with weak demand-pull inflation pressures, no sign of a wage-price spiral and a pause by global central banks to assess the impact of previous

monetary policy tightening, we expect the SA Reserve Bank (SARB) to keep the repo rate constant at 8.25% in the last interest rate setting meeting for 2023 (23 November).

- While events which posed potential currency and sovereign premium risks (BRICS summit, African Growth and Opportunity Act (AGOA) summit and the Medium-Term Budget Policy Statement (MTBPS)) have occurred without significant market implications, risks to the inflation outlook remain and inflation expectations are still uncomfortably high. Therefore, we maintain our stance of rates remaining restrictive with a possibility of the first repo rate cut in the second quarter of 2024, at the earliest.

Headline inflation shot up toward the upper end of the inflation target range

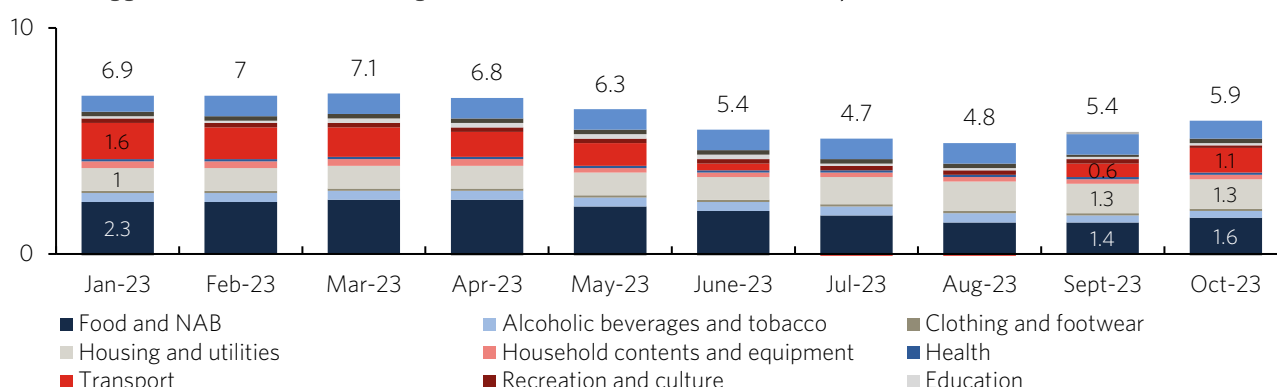
As reported by Stats SA, headline inflation surged to 5.9% y/y in October 2023 from 5.4% y/y recorded in September 2023. This was well above the Reuters median consensus of 5.5% y/y and marks the third consecutive month of an acceleration in consumer prices from the recent low of 4.7% y/y in July as seen in chart 1. The reason behind consistently higher inflation rates in recent months has been an increase in fuel prices due to higher international oil prices coupled with a weak domestic exchange rate. In the October print, food inflation was also a major contributing factor to the surprising spike in the headline inflation rate. As seen in chart 1, transport inflation contributed 1.1 percentage points to the headline rate of 5.9%, higher than the previous month's contribution of less than 1 percentage point. The contribution from food and NAB also increased from 1.4 percentage points to 1.6 percentage points in October. Housing and utilities was also a

major contributor but its contribution was constant at 1.3 percentage points.

Restaurants and hotels recorded a sharp rise in inflation from 4.2% y/y in September to 6.3% y/y in October, above the inflation target range. Of the 27 inflation categories, 10 categories (up from nine) recorded inflation of above 6% in October and nine (up from seven) recorded a rate between the 3% to 6% range. This points to more inflationary pressure during October.

However, underlying inflationary pressures are subsiding. Following the larger-than-expected drop in core inflation to 4.5% y/y in September, core inflation decelerated to 4.4% y/y in October, slightly higher than the Reuters median consensus of 4.3%.

Chart 1: Bigger contribution stemming from food and NAB as well as transport inflation

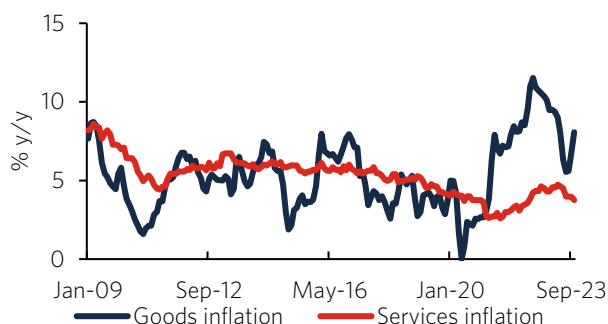


Source: Global Insight, Stats SA, Momentum Investments

October is a low survey month as fewer than 3% of items are surveyed in addition to the constant monthly surveyed items. The additional items include gymnasium fees, funeral expenses, funeral policies,

gravestone maintenance, television licenses and local bus fares. There were no price spikes recorded in any of these items.

Chart 2: The gap between goods and services is widening again



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

On the back of higher food and fuel inflation, goods inflation climbed to 8.1% y/y in October from 6.8% y/y in September as seen in chart 2. On the other hand, services inflation dropped to 3.8% y/y after recording 4% y/y in the past three consecutive months.

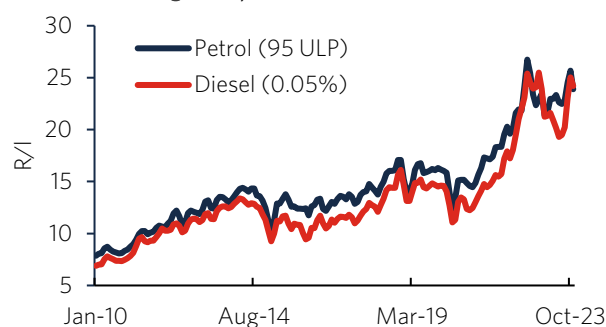
Fuel prices are receding but geopolitical risks remain

The CEF announced October fuel price increases of R1.14/l for petrol (inland 95) and R1.97 for diesel (0.05%). These increases resulted in the price of petrol being R25.68/l (20% higher than in January 2023) and diesel costing R25.02/l (17.9% higher than in January 2023). Higher fuel prices drove up transport inflation to 7.4% y/y in October from 4.2% y/y in September.

As anticipated, fuel prices dropped by R1.78/l for both grades of petrol and by R0.85/l for diesel (0.05%) in November as seen in chart 3. This will alleviate pressure on transport inflation in the November inflation print. A contributing factor to lower fuel prices was the drop in the average price of Brent crude oil in October. The spot price of Brent crude oil averaged US\$90.8/bbl in October, lower than the EIA's forecast of US\$93/bbl and outcome of US\$93.7 bbl in September. Lower international oil prices outweighed the slightly weaker exchange rate during October (average of R19.05/US\$ compared to R18.99/US\$ in September)

Early data from the CEF points to a further drop in the price of petrol (inland 95) by approximately R1.08/l and R2.23/l for diesel (inland 0.05%) in December according to the over-recovery estimated on 20 November 2023. This will provide further reprieve to consumers and reduce pressure on headline inflation. The stronger domestic currency averaging R18.43/US\$ month-to-date (1 to 21 November) will contribute toward lower fuel prices.

Chart 3: Cooling fuel prices



Source: CEF, Momentum Investments
Data until November 2023

While inflationary pressures adversely affect households in the lower expenditure deciles as illustrated in table 1, the diagram also illustrates that households in the upper expenditure deciles are disproportionately affected by a rise in fuel prices. The hefty fuel price increase in September (R2.85/l for diesel (0.05%) and R1.71/l for both grades of petrol) is likely the major driver of the 0.8 percentage points increase in the inflation rate to 5.2% y/y for households in the ninth expenditure decile in September. Households in the lowest expenditure decile registered a lower increase of 0.2 percentage points in the same period. The October fuel price increases had a similar effect with the inflation rate of households in expenditure decile nine rising by 0.6 percentage points to 5.8% y/y. As such, we are likely to see a relatively bigger drop in the inflation rate within the higher expenditure deciles in November and December as fuel prices drop.

Table 1: Households in the lower expenditure deciles disproportionately affected by inflationary pressures

	Household expenditure deciles*									Headline CPI
	1	2	3	4	5	6	7	8	9	
Jan	10.8	10.3	9.0	7.9	7.7	7.3	7.3	7.1	7.2	6.9
Feb	11.0	10.4	9.0	7.9	7.6	7.3	7.2	7.1	7.2	7.0
Mar	11.3	10.7	9.2	8.2	7.9	7.4	7.3	7.2	7.1	7.1
Apr	11.3	10.6	9.2	8.0	7.8	7.4	7.1	7.0	6.8	6.8
May	9.9	9.4	8.1	7.2	7.0	6.7	6.5	6.3	6.4	6.3
Jun	9.1	8.6	7.6	6.5	6.5	6.0	5.8	5.4	5.3	5.4
Jul	9.3	8.7	7.4	6.3	6.2	5.5	5.1	4.6	4.2	4.7
Aug	8.1	7.7	6.5	5.7	5.6	5.1	4.8	4.6	4.4	4.8
Sep	8.3	7.8	6.8	5.9	5.8	5.4	5.3	5.2	5.2	5.4
Oct	8.9	8.2	7.1	6.5	6.4	5.8	5.9	5.8	5.8	5.9

Source: Global Insight, Stats SA, National Treasury, Momentum Investments

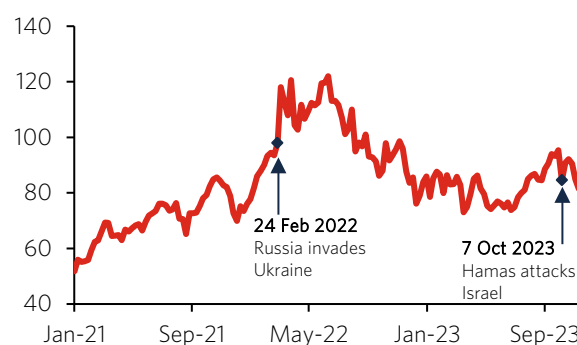
* Decile 1: up to R20 140, decile 2: R20 141 up to R33 619, decile 3: R33 620 up to R48 673, decile 4: R48 674 up to R65 213, decile 5: R65 214 up to R84 698, decile 6: R84 699 up to R109 163, decile 7: R109 164 up to R143 174, decile 8: R143 175 up to R199 920, decile 9: R199 921 up to R312 246, decile 10: R312 247 and more

In the October inflation note, we flagged three scenarios from Bloomberg looking into the negative impact of a possible escalation of the Gaza-Israel war on oil prices, growth, inflation and the VIX (volatility index). As seen in chart 4, the price of Brent crude oil spiked as an initial reaction to the war but over a month later, Brent crude oil is trading lower than when the war started on 7 October 2023. An article published in *The New York Times* notes that this is because oil supplies have not been disrupted as Gaza produces no oil and Israel produces a small amount of oil. The International Energy Agency (IEA) also notes that the war has not impacted oil supply flow. *The New York Times* further suggests that market participants do not view the war as an immediate risk but note that the risk of a broader war cannot be ruled out.

According to the IEA November Oil Market Report, world oil output increased in October due to higher-than-expected supply from the US and Brazil. This is likely cushioning against the OPEC plus (Organisation of the Petroleum Exporting Countries) oil supply cuts. However, global demand still exceeds global supply as

the Northern Hemisphere enters winter. Therefore 'market balances will remain vulnerable to heightened economic and geopolitical risks.

Chart 4: Weekly price of Brent crude oil (US\$/bbl)



Source: Bloomberg, The New York Times, Momentum Investments
Data until 17 November 2023

The SARB has expressed relative comfort with international oil prices remaining in the range of US\$85/bbl to US\$90/bbl. However, a surge to around US\$96 and above is viewed as negative for the inflation outlook and may warrant more restrictive policy.

Renewed food price pressures

Domestic food inflation accelerated to 8.8% y/y in October 2023 from 8% y/y in September. This follows six consecutive months of moderation in food inflation from the peak of 14.4% y/y in March 2023. Five of the nine food groups recorded a higher inflation rate in

October. The largest increase between September and October was recorded in vegetables (8.3 percentage points to 23.6% y/y) followed by smaller increases in oils and fats (2.1 percentage points to negative 5.6% y/y), fruits (1.8 percentage points to 8.5% y/y) and

milk, eggs and cheese (1.2 percentage points to 12.4% y/y). Stats SA notes that higher vegetables inflation was driven by potatoes (a record high of 64.6% y/y in October, up from 32.6% y/y in September), tomatoes, pumpkin and sweet potatoes.

According to the Department of Agriculture, Land Reform and Rural Development, the new wave of the Avian flu started in March 2023 and has gradually been getting worse as the months progress. The impact of this outbreak has been mostly felt in the supply of eggs and the price of egg prices, especially since September 2023. As illustrated in chart 5, the inflation rate on eggs accelerated to 10.8% y/y in September and a further acceleration to 24.4% y/y was recorded in October.

Chart 5: Egg inflation shoots up to 24.4% y/y



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

The Pietermaritzburg Economic Justice and Dignity Group Household Affordability Index tracks a household food basket which includes 44 foods across certain areas within six cities in SA. The index reveals that the average price of 60 eggs was 19.5% higher in October compared to a month ago (R162.1 up from R135.7 in September) and 36.4% higher than a year ago. On the other hand, the average price of 10kg frozen chicken portions was slightly lower in October at R384.66 from R390.97 in September but we note that other cities such as Johannesburg recorded price increases. The spike in potato prices was also reflected in the Household Affordability Index. A 10kg bag of potatoes was R145.31 in October, 40% more than in

September (R103.85) and 102% more compared to a year ago (R71.96).

In an article published by *Cape Business News*, the CEO of SAPA explains that the shortages and price impact have so far been seen for eggs and not chicken meat because eggs have a short shelf life and this makes it difficult to import eggs whereas chicken meat has a longer lead time between culling and slaughtering (around one month). Furthermore, the Agriculture Business Chamber of SA has noted a lag of around three months between slaughtering and (consumer) food inflation.

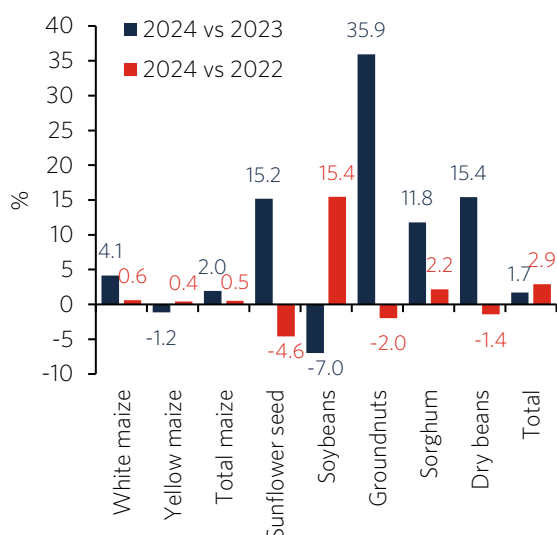
SAPA indicates that the shortage of eggs is expected to continue until December 2023 with a full recovery expected between May 2024 and May 2025 because the chickens need to be replaced and it takes six months for the replaced chickens to come back into production. The impact on chicken meat shortages is estimated to be mostly felt at the end of November and into December 2023. However, preventative measures including stock build up and imports have been taken to reduce the shortage of chicken meat in December. SAPA reassures that despite the shortages, this is not a crisis and notes that the peak of the disease was in mid-September 2023.

According to the CEC's October release, producers intend to plant 4.5 million hectares of summer crops in 2024. This represents a 1.7% increase from 2023 and a 2.9% increase from the total area planted in 2022. Of the 4.5 million hectares, 59% is intended for maize (57.9 in the last season), 23.9% for soybeans (25.7% previously), 14.3% for sunflower seed (12.4% previously) and the remaining 2.7% (previously 2.3%) is split between groundnuts, sorghum, and dry beans.

As seen in chart 6, while the 2024 intended area to plant within the various crops is reflecting rather sizeable growth relative to 2023, we note that it does not vary greatly from the total area planted in 2022 (i.e. there is a reversal of the decrease in hectares used between 2022 and 2023). For instance, the expected planting for groundnuts is projected to increase by 35.9% in 2024 but it was reduced by 27.9% in 2023.

As such, the intended area to plant groundnuts in 2024 may be more than in 2023 but it is 2% lower than in 2022.

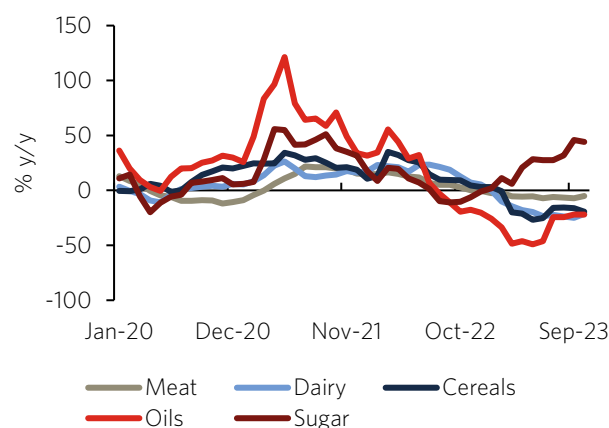
Chart 6: 2024 intended hectares to plant summer crops relative to 2023 and 2022



Source: CEC, Momentum Investments

Internationally, the real (inflation-adjusted) FAO Food Price index decreased slightly to 116 points in October from 116.6 points in September. The decrease was broad-based but the biggest drop was observed in the sugar price index from 156.5 points to 153.1 points. Nevertheless, the sugar price index is still higher than a year ago by 44.1% y/y as seen in chart 7.

Chart 7: Global sugar price index remains elevated



Source: FAO, Momentum Investments
Data October 2023

Interest rates likely to remain on hold

Although October's inflation rate exceeded expectations, we expect the blip to be temporary with lower fuel inflation driving down the headline figure in the coming releases. Our estimate of an average headline inflation rate of 5.9% in 2023 remains broadly unchanged and is broadly in line with the Reuters median consensus published in the October survey results and the SARB's estimate communicated in the September interest rate setting meeting. In the absence of shocks that would result in inflation deviating from the projected trajectory, we view inflation settling within the inflation target in 2023 as a positive milestone considering the average inflation rate of 6.9% in 2022. Progress in the fight against inflation may be attributed to the SARB acting ahead of the curve and the success of the inflation target in keeping inflation expectations from being excessively de-anchored.

Encouragingly, events such as the BRICS summit, the AGOA summit and the MTBPS have, to a large extent, occurred without a lot of the risks that were

surrounding these events in the months prior materialising.

For these reasons, together with weak demand-pull inflation pressures, no sign of a wage-price spiral and a pause by global central banks to assess the impact of previous monetary policy tightening, we expect the SARB to keep the repo rate constant at 8.25% at the last interest rate setting meeting for 2023 (23 November). If rates are kept constant, the SARB would have implemented a cumulative 125 basis points of hikes in 2023 and 475 basis points of hikes since the start of the hiking cycle in November 2021. Since the inflation targeting regime (introduced in February 2000) SA has experienced three steep hiking cycles (including this cycle). The previous two cycles were between 2001 and 2000 where rates were hiked by 400 basis points and the largest hiking cycle was between 2006 and 2008 (500 basis points) as seen in table 2.

Table 2: Top three largest interest rate hiking cycles since inflation targeting

Duration	From	To	Cumulative hike
Dec 2001 to September 2002	9.5%	13.5%	400 basis points
May 2006 to June 2008	7%	12%	500 basis points
October 2021 to current	3.5%	8.25%	475 basis points

Source: Iress Momentum Investments

The November interest rate setting meeting will take place prior to the release of the fourth quarter inflation expectation results collected by the Bureau for Economic Research. The fourth quarter inflation expectations would have given members of the Monetary Policy Committee (MPC) an idea of how the market perceives the inflation trajectory particularly on the back of three consecutive increases in the inflation

rate. On the back of this, the larger-than-anticipated October inflation rate, fiscal risks, food inflation risks and geopolitical risks, the SARB will likely continue to express caution on the inflation outlook (as with the previous two meetings when rates were kept constant). We maintain our stance of rates remaining restrictive with a possibility of the first repo rate cut in the second quarter of 2024, at the earliest.

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