



Inflation spike reverses in November 2023

Highlights

- According to Statistics South Africa (Stats SA), headline inflation (CPI) decelerated to 5.5% year-on-year (y/y) in November 2023 from 5.9% y/y in October, positively surprising the market's expectation (Reuters median consensus) of 5.6% y/y.
- Core inflation ticked up slightly to 4.5% y/y in November against the Reuters median consensus expectation of 4.4% y/y (unchanged from the previous month).
- The drop in fuel prices during November is the main reason for the softer inflation figure. Further price decreases announced in December will provide additional reprieve for the December inflation figure. Transport inflation decelerated to 4.3% y/y in November from 7.4% y/y in October. According to early data from the Central Energy Fund (CEF), we can expect fuel price cuts in January 2024 of R0.78/l for petrol (inland, 95) and R1.40/l for diesel (inland, 0.05%). Nevertheless, recent rand weakness could reduce the size of these cuts.
- International oil prices have been a bigger driver of lower fuel prices in the past two months despite ongoing conflict in the Middle East. According to the United States (US) Energy Information Administration (EIA), the average price of Brent crude oil decreased to US\$82.9/bbl in November. This represents a 11.5% drop since the recent peak in September 2023.
- Upward price pressure on Brent crude oil prices is expected in the first quarter of 2024 on the back of additional Organisation of the Petroleum Exporting Countries Plus (OPEC+) oil production cuts announced in November 2023.
- Producer price inflation (PPI) for food products edged up to 5.5% y/y in October (4.5% y/y in September) which signals upward pressure on consumer food inflation. In November, domestic food inflation on a consumer level accelerated for the second month to 9% y/y from 8.8% y/y in October.
- There are upside risks to food price inflation in 2024 namely, geopolitical tensions, El Niño and loadshedding. However, the SA Reserve Bank (SARB) expects food inflation to moderate markedly to 5.5% (revised up) in 2024 from an upwardly revised 10.6% in 2023. This is likely on the back of high base effects, good soil moisture and better planting intentions.
- Recent trends in the inflation rate experienced by pensioners suggest that pensioners are more vulnerable to elevated food inflation. There is uncertainty about the initial inflationary impact of the two-pot retirement system set to be implemented on 1 September 2024. If the long-term objective of improving retirement savings is achieved, pensioners could become less vulnerable to inflationary shocks.
- With November's inflation figure surprising positively and the expectation of a further deceleration in December, we do not foresee major deviations from the SARB's estimate of inflation averaging 5.8% in 2023 (broadly in line

with our estimate of 5.9%). Nevertheless, risks to the inflation trajectory remain and inflation expectations are still elevated. As such, we expect the SARB to keep the repo rate constant at 8.25% in the January 2024 interest rate setting meeting. We maintain our view that the SARB will likely implement the first interest rate cut in the second quarter of 2024.

Slightly better-than-anticipated drop in headline inflation

After three consecutive spikes in the headline inflation rate since the recent trough of 4.7% y/y recorded in July 2023, Stats SA reported a dip in CPI from 5.9% y/y in October to 5.5% y/y in November. This was largely due to the notable drop in fuel prices. The softer inflation rate positively surprised the Reuters median consensus expectation of 5.6% y/y.

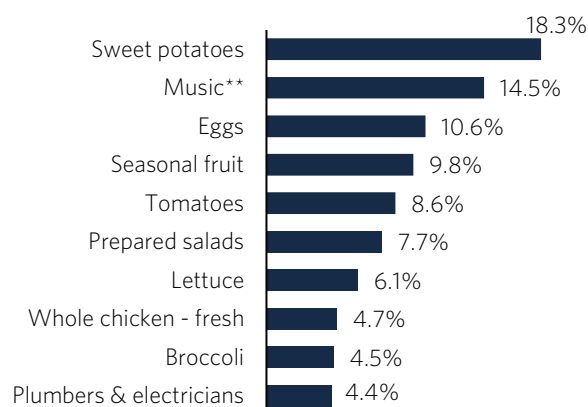
Core inflation was slightly higher at 4.5% y/y in November from 4.4% y/y in October. The main contributing factor was maintenance and repairs increasing by 5.4% y/y in November from 4.4% y/y in October on the back of rising rates for plumbers and electricians (surveyed biannually in May and November). The increase in rates for plumbers and electricians (7.4% y/y in November) resulted in the category featuring in the top 10 most expensive products in the past month as seen in chart 1. However, underlying inflationary pressures remain well contained. Only seven of the 19 core inflation categories recorded inflation above 6% in November.

The majority of the most expensive products on a month-on-month basis (see chart 1) as well as on a year-on-year basis (see chart 2) were food products. This is reflective of renewed local food price pressures. According to Stats SA, food and non-alcoholic beverages accelerated to a four-month high of 9% y/y in November from 8.7% y/y in October. Eggs featured on both lists due to the Avian flu outbreak.

Fuel price drop alleviates inflationary pressures

Transport inflation moderated to 4.3% y/y in November and contributed 0.7 of a percentage point to the headline inflation rate. This was lower than 7.4% y/y (1.1 percentage point contribution) in October largely owing to lower fuel prices. Private transport inflation (mostly fuel) decelerated sharply from

Chart 1: Biggest price increases in the past month*

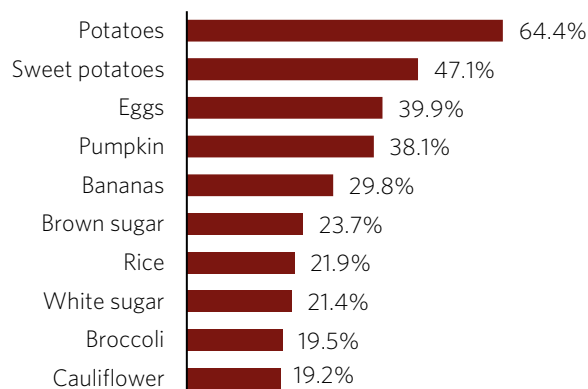


Source: Stats SA, Momentum Investments

* November 2023 vs October 2023

** Pre-recorded CDs/subscription music

Chart 2: Biggest price increases over the past year*



Source: Stats SA, Momentum Investments

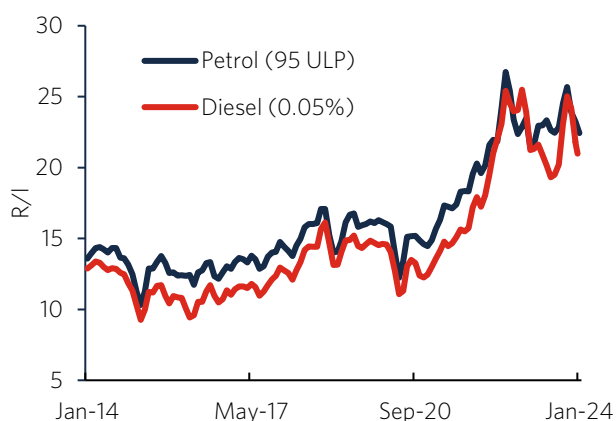
* November 2023 vs November 2022

10.2% y/y in October to 2.4% y/y in November. On the other hand, public transport inflation rose by 0.8% y/y from negative 0.3% y/y over the same period.

As announced by the CEF, the price of petrol (both grades) dropped by R1.78/l in November and diesel (0.05%) dropped by R0.85/l. The fuel price decreases

led to the deceleration in transport inflation. We can expect further moderation in transport inflation during December 2023 and January 2024 on the back of a R2.35/l drop in the price of diesel (0.05%) and a R0.65/l drop in both grades of petrol during December and additional price decreases in January. Early data from the CEF (12 December) is suggestive of a R1.4/l cut in the price of diesel (0.05%) and a R0.78/l cut in the price of petrol (95). This would take fuel prices to levels last reached in August 2023 as seen in chart 3.

Chart 3: Potential fuel price drop in January 2024



Source: CEF, Momentum Investments
January 2024 is an estimate

Fuel price developments are largely influenced by international oil price movements and the exchange rate.

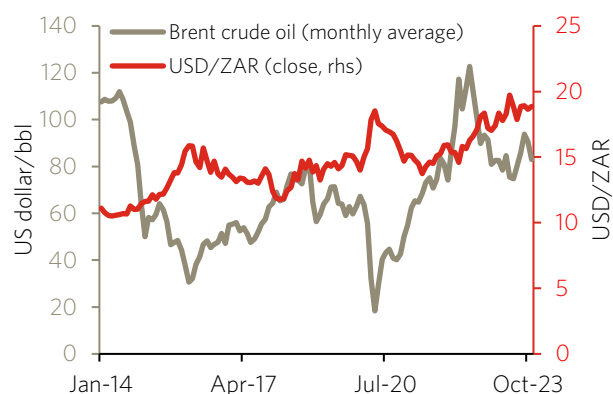
According to the EIA, the average price of Brent crude oil decreased for the second consecutive month to US\$82.9/bbl in November (see chart 4). This represents a 11.5% drop since the recent peak in September 2023 (US\$93.7/bbl). In its December Short-Term Energy Outlook, the EIA revised the

Food inflation expected to decelerate in 2024

Domestic food inflation accelerated for a second consecutive month to 9% y/y in November. Higher food prices were recorded in five of the nine food categories. Meat inflation inched higher to 3.5% y/y in November (3.4% y/y in October), milk, eggs and cheese inflation accelerated to 13.9% y/y (12.4% y/y)

forecast for Brent crude oil down to US\$82.40/bbl for 2023 (previously US\$83.99/bbl). The forecast for 2024 was revised markedly down to US\$82.57/bbl (previously US\$93.24/bbl). The upward price pressure is expected in the early part of 2024 on the back of additional OPEC+ oil production cuts announced in November 2023 but effective January to March 2024. Oil production cuts from Saudi Arabia are set to expire at the end of 2024 and oil production from OPEC+ is expected to remain below targets.

Chart 4: Price of Brent crude oil below US\$90/bbl in November



Source: EIA, Iress, Momentum Investments
Data until November 2023

The rand appreciated slightly in November to an average of R18.53/US\$ from R19.05/US\$ in October. According to Investec, the rand could have strengthened significantly in November on the back of higher metals prices but the inefficiencies at Transnet have hampered exports and consequently dampened rand strength. The recent rand weakness to an average of R18.89/US\$ between 1 and 11 December 2023 could reduce the size of the estimated fuel price cuts in January 2024.

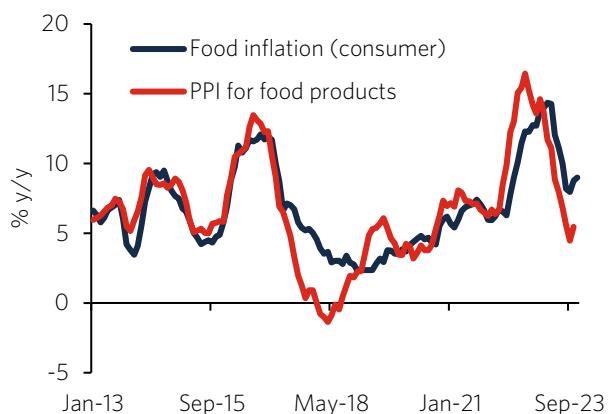
and fruits inflation rose to 11.5% y/y (8.5% y/y). Higher food prices are reflective of the Avian flu outbreak.

According to the minister of Agriculture, Land Reform and Rural Development, the Avian flu outbreak is under control in SA and the replenishment of eggs is underway. The supply constraints are expected to

normalise early next year and we should consequently see a moderation in egg inflation. Egg inflation accelerated further to a high of 39.9% y/y in November after the surge to 24.4% y/y in October.

On a producer level, food inflation ticked up to 5.5% y/y in October from 4.5% y/y in September (see chart 5). The biggest increases were observed in meat and meat products (4.3% y/y); fruits and vegetables (8.1% y/y); and sugar (28.4% y/y). Deflation in oils and fats decelerated to 2.1% y/y in October from negative 13.7% y/y in September.

Chart 5: Uptick in PPI for food products signals upcoming price pressure at a consumer level



Source: Global Insights, Stats SA, Momentum Investments
Food inflation (consumer) data until October 2023

Internationally, the United Nations (UN) Food and Agriculture Organization (FAO) real Food Price Index was unchanged in November from the revised 115.8

points in October. This is because the increases in the vegetable oils, dairy products and sugar categories were offset by the decreases in cereals and meat. The UN notes that international poultry prices were down in November due to increased supply (mainly from Brazil) despite production challenges from the Avian flu outbreak across many countries.

On a y/y basis, the rate of deflation in the overall index along with the meat, dairy, and oils sub-indices decelerated. Deflationary forces in the cereals price index strengthened. Sugar prices moderated in November (y/y) but the sugar price index was still the only category where prices are above what they were a year ago.

The surprise spike in domestic food inflation to 8.8% y/y in October was likely the reason behind the SARB's upward revision of food inflation to 10.6% in 2023 (previously 10.4%). The estimate for 2024 was also revised up but is projected to be significantly lower than 2023 at 5.5%. The deceleration of food inflation in 2024 will likely be supported by high base effects and easing international food prices. There are upside risks to food inflation namely, geopolitical tensions, El Niño and loadshedding. *Agricultural Economics Today* reports that the likelihood of dry weather conditions has been pushed out from the first quarter of 2024 to the second quarter. This, along with good soil moisture in most parts of SA as well as farmers' intentions to plant more crops than in the previous season as detailed in our November inflation note, is expected to yield good summer crops in the 2023/24 season.

Cost of living for pensioners above headline inflation

Historically, headline inflation is more aligned with the inflation rate of households in the higher expenditure deciles (deciles 8 to 10 - R143 175 and more) because these households make up the bulk of total expenditure. In November 2023, households in the upper expenditure decile experienced an inflation rate of 5.3% y/y, lower than the headline inflation of 5.5% y/y. This group's inflation rate dropped from 5.9% y/y in October in line with the substantial decrease in transport inflation. As seen in chart 6, the inflation rate of pensioners has historically tracked the CPI of upper

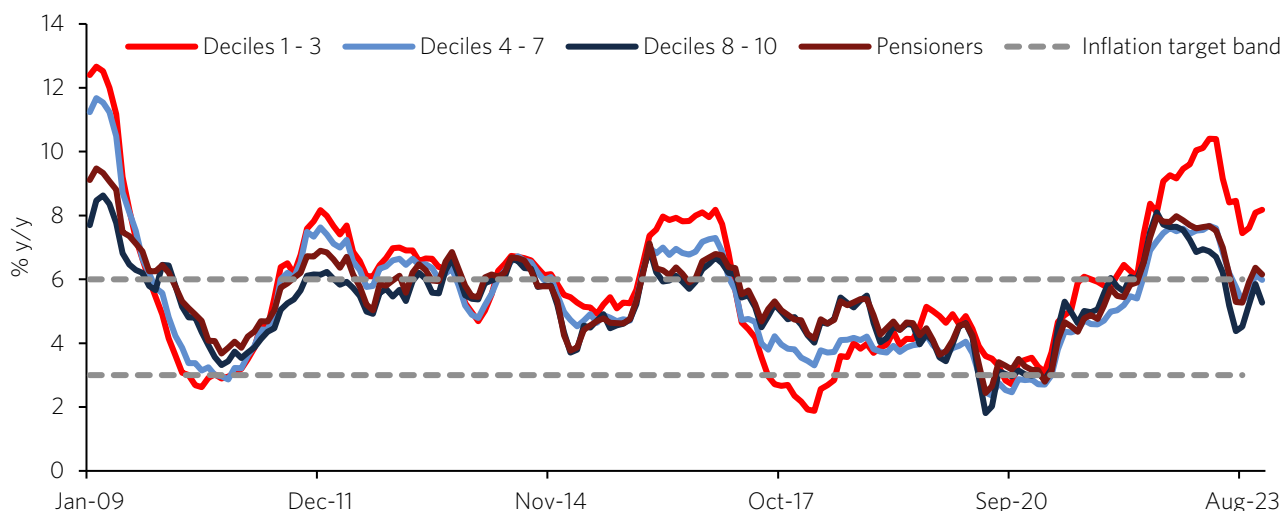
expenditure decile households very closely and consequently tracked close to the headline inflation rate. This could be partly explained by the fact that high-income earners are more likely to save for and preserve their savings until retirement.

However, inflation for pensioners has recently (since February 2023) been more aligned with CPI recorded for households in the middle expenditure deciles (deciles 4 to 7 with an annual expenditure between R48 674 and R143 174) which means pensioners have been

experiencing above headline inflation rates for the most part of 2023. This also signals that pensioners are more vulnerable to higher food inflation. Pensioners experienced an inflation rate of 6.2% y/y in November, down from 6.4% y/y in October but higher than the headline inflation rate.

Households in expenditure deciles 1 to 3 were the only ones who experienced an uptick in inflation in November (8.2% y/y from 8.1% y/y in October). This is explained by renewed food price pressures because these households spend a large portion of their budget on food.

Chart 6: Pensioners' CPI has historically tracked that of households in the higher expenditure deciles until recently



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

The two-pot retirement system is expected to come into effect on 1 September 2024. The reform to the retirement system aims to allow annual member withdrawals while in employment to prevent employees from resorting to withdrawing their full savings in times of need. The long-term intention is to improve the replacement ratio at retirement. According to National Treasury, the average replacement ratio is between 25% and 30% which means that employees cannot retire comfortably.

The immediate inflationary impact of the two-pot retirement system has not yet been established but employees are expected to take advantage of the early withdrawal access to their retirement savings to either fund expenditure or repay debt. If the objective of improving the replacement ratio is achieved over time, higher savings at retirement could make pensioners less vulnerable to inflationary shocks.

No rush to cut interest rates

Given the positive surprise in the November inflation rate and the anticipated deceleration in December, we expect headline inflation to average 5.9% in 2023 (broadly in line with the SARB's projection and Reuters median consensus of 5.8%). Despite risks to the inflation outlook (weak exchange rate, high international oil prices, geopolitical tension, El Niño and administered prices) we expect inflation to retreat in 2024 to 4.9% (one percentage point lower than the SARB's estimate) and stabilise at 4.5% in 2025.

Against the backdrop of elevated inflation risks, we expect the SARB to keep the repo rate constant at 8.25% in the January 2024 interest rate-setting meeting.

The Bureau for Economic Research is scheduled to release the results of the next inflation expectations survey on 14 December and there is a possibility that expectations may have ticked up since the last survey due to higher food and fuel inflation on a backdated

basis. Inflation expectations according to the September survey stood at 6.1% for 2023, 5.5% for 2024 and 5.3% for the next two years. The longer-dated (five-year average) expectation was also high at 5.1%. The SARB remains committed to anchoring inflation expectations. Keeping rates elevated in January and talking tough on inflation will signal to market participants that the SARB is serious about guiding inflation back to the midpoint of the inflation target range, particularly given the dangers of high inflation to lower-income households.

A softening in core inflation signals contained demand inflation and the low likelihood of a wage-price spiral suggests limited second-round effects.

In the absence of these highlighted risks materialising, we maintain our view that the SARB's first repo rate cut will be in the second quarter of 2024 with a cumulative 75 basis points of cuts by the end of 2024. Notably, the SARB's Quarterly Projection model is guiding toward a shallower cutting cycle of 50-basis points in 2024.

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