Efficient Research

Double Digits

23 April 2008

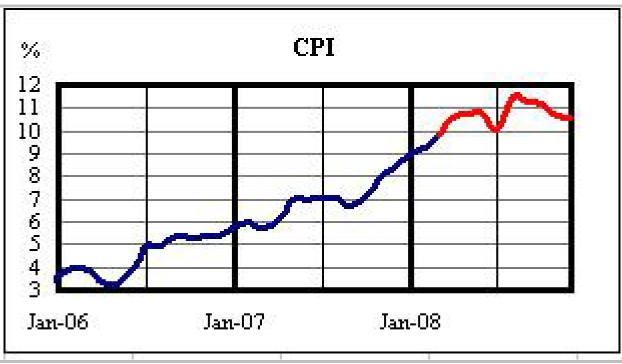
StatsSA released the March consumer inflation data today, reporting inflation of above 10% in both the CPI figure, 10.6% y:y, and CPIX figure, 10.1% y:y. In February these figures reported y:y rises of 9.8% and 9.4%, respectively. These double digit numbers are indicative of the escalating inflation pressure in the economy. March has been the 12th consecutive month that CPIX has breached the target band of 3% - 6% set by the South African Reserve Bank (SARB). In other words, inflation has not been within target for a full year! These latest numbers provide support for the possibility of another rate hike announcement in June, following the 50 basis point increase earlier this month.

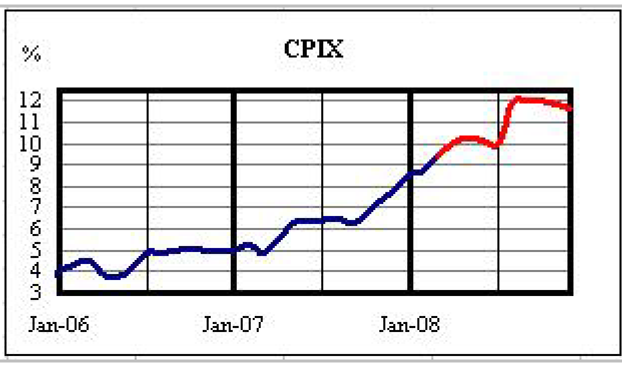
The following is a summary of March CPI and CPIX:

	Actual		
	March '08 Y:Y	**March '08 M:M**	**March '07 Y:Y**
CPI	10.6%	1.6%	6.1%
CPIX	10.1%	1.6%	5.5%

Notes:

The 10.1% y:y rise in CPIX of March is the strongest rise since December 2002 (10.8%). Our calculations indicate that CPIX should remain above 10% for most of the year, peaking in August. In fact, if Nersa grants Eskom's 60% proposed increase in electricity prices, our expectation for CPIX averages around 10.7% for 2008.
Certain data specific considerations for the month include the collection of prices regarding Education. This index is usually updated annually and showed a 8.3% y:y rise in March. Education carries a weight of 3.8% in the inflation basket. StatsSA has, since January 2008, changed the method of collecting prices for footwear and clothing to exclude the prices of discounted items. Their estimates on the bias resulting from the non-discounted prices were published and reported a 0.19% upward bias in CPI data and a 0.2% upward bias in the CPIX counterpart. Another factor to be considered in March's figures is the updated wages of domestic workers that should have been included in the month's data. Due to a larger number of workers employed in this sector (as recorded in the Labour Force Survey) and comparability difficulties, StatsSA's did not update this data but has committed to do so in April 2008. Domestic workers (falling into the household operations sub-sector) has a weight of 3.6% in the CPIX basket and the (not yet updated) item rose by 6.7% y:y in March 2008.





Blue is actual - Red is our forecast.

Percentage change Y:Y

Item	CPI	CPIX
Food	15.3%	15.6%
Housing	10.2%	7.1%
Transport	16.1%	15.1%
Medical care and health expenses	5.9%	5.6%
Total	**10.6%**	**10.1%**

The following contributed to the major indices during March Y:Y:

Item	CPI	CPIX
Food	3.6	4.4
Transport	2.4	2.1
Housing	2.1	0.9
Medical care and health expenses	0.5	0.5
Other	2.0	2.2
Total	**10.6**	**10.1**

Notes:

Food makes up around a quarter of the inflation basket and strong rises in the price of these items remains the largest driver behind consumer inflation in the economy. *Food* inflation accelerated from around 8.0% y:y in the first quarter of 2007, to 14.5% y:y in the first quarter of 2008, and has now consistently recorded double digit increases since July 2007. In the CPIX basket, the larger food sub-categories like *grain products,* rose by 22.9% y:y (February: 20.7%) while *meat* rose by 9.0% y:y (February: 7.3%). *Milk cheese and eggs* rose by 25.5% y:y, while *fats and oils* jumped a stellar 52.7% if compared to March 2007! On the production side, food inflation (for both agricultural and manufactured goods) is also amongst the major drivers behind the PPI - no doubt spilling through to the consumer side.

Transport costs are the second strongest inflation driver, increasing 15.1% y:y, higher than the 13.2% y:y rise recorded in February and recording its highest increase since CPIX data became available in 2000. The 61 cents hike in fuel prices in the first week of March supported the increase in transport prices, and the additional hike earlier this month will continue to put pressure on this index in April.

The *housing* item, incl. inter alia rent, home-owner's costs, boarding fees etc., rose 7.1% in March 2008 y:y. This is likely due to housing related costs being fuelled by the recent upwards interest rate cycle.

Noteworthy is that the sub-index *personal care* increased sharply in March 2008 with 7.3% y:y, from a 5.9% y:y rise in February 08. Beauty services carry the largest weight in this sub-index and this could be indicative of services prices catching up to those of goods.

Furniture and equipment carries a weight of around 3% in the inflation basket. In March, prices for this category has actually decreased 1.1% y:y. The latest retail figures show that furniture and household equipment retailers are under severe strain, reporting decreases in sales for the last 9 months. A decline in prices of these goods could indicate retailers' efforts in promoting sales.

Amongst the 17 major CPIX sub-indices, 11 categories rose by 6.0% y:y or more, an additional 2 categories when compared to a month ago, signalling the secondary-round impact of inflation.

Percentage change M:M

Item	CPI	CPIX
Transport	0.5	0.5
Food	0.4	0.4
Other	0.7	0.7
Total	**1.6**	**1.6**

Notes:

Transport costs were the main driver behind inflation on a monthly basis. Strong rises in international oil prices accompanied by a sharp weakening in the rand from January 2008 onwards have been driving domestic fuel prices. Running costs for March were 5.6% higher than in February 2008. *Food* price increases remains another culprit in the inflation story. Food makes up around half of the poor's expenditure items and sharp increases are hampering this group's purchasing power.

A deterministic driving factor of inflation is, in fact, inflation *expectations* - not under the direct control of the Reserve Bank. The anticipated increase in the general price level will largely determine actual increases, as inflation expectations are core in wage negotiations, price setting by producers, manufacturers etc. and so key in determining the secondary-round effects in the inflation process. Research done by the Bureau for Economic Research (BER), shows that inflation expectations are on the rise. For 2008, expectations of CPIX have increased from an average of 5.9% previously, to 7.8% currently. Expectations for 2009 are also higher – 7.0% from 5.6% previously. One of the supporting arguments for the use of inflation targeting is that it can act as an anchor to inflation expectations. The anchoring effect however can only come in to affect if the Reserve Bank is credible (i.e. consistently succeeds in keeping inflation within the target) – a much debated issue of late. The SARB showed their commitment to fighting inflation when they raised the main interest rate with 50 basis points in April. Higher interest rates help in limiting the capability of price increases in certain goods (e.g. oil, food, etc.) to flow through to the rest of the economy – 'capping' secondary impacts as well as inflation expectations. However, the March inflation figures released today will make the Bank's job more difficult as pressure mounts on both actual and expected inflation with the possibility of another rate hike in June becoming more likely.

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