Inflation: CPI

Efficient Group

The Good, the Bad and the (not so) Ugly

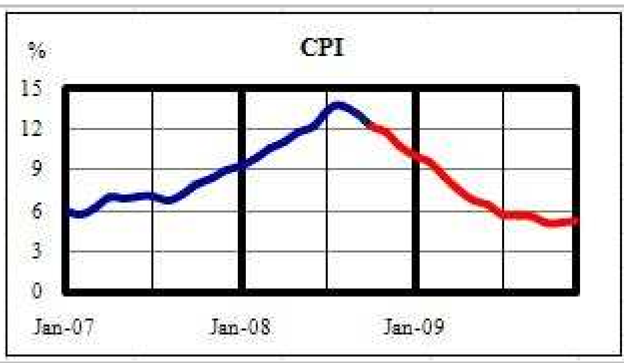
26 November 2008

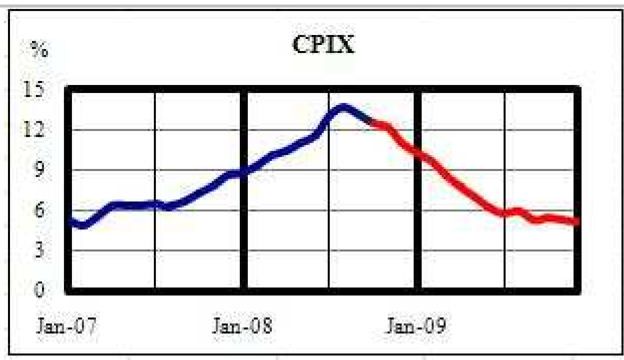
October consumer inflation figures:

- **CPI** metropolitan areas; **12.1%** y/y (September: 13.1% y/y)
- **CPIX** metropolitan and urban areas; **12.4%** y/y (September: 13.0% y/y)
- **I-Net consensus:** CPI 12.4% y/y, CPIX 12.5% y/y.

The following is a summary of October CPI and CPIX:

	Actual		
	October '07 Y:Y	**October '08 M:M**	**October '08 Y:Y**
CPI	7.9%	0.0%	12.1%
CPIX	7.3%	0.2%	12.4%





Blue is actual - Red is our forecast.

The Main Contributors (CPIX):

Food prices have been accelerating at an average pace exceeding 18.0% y/y since June 2008. In October, food prices cooled their advance slightly to **17.2%** y/y from 17.9% y/y in September. Processed goods make up the bulk of consumer foodstuffs and increased with 22.0% y/y in the month, whilst prices of unprocessed goods were 11.7% higher y/y.

Transport costs declined by 1.3% month-on-month as the relative small decrease in the petrol price came through. The year-on-year change was **16.1%** - a slightly slower pace than the 16.4% average y/y increase that the category recorded for the year to September

Fuel and Power was the third largest contributor to the overall inflation rate, increasing at a rate of **28.3%** y/y (29.9% y/y in September). The electricity price hike that was awarded to Eskom in July is likely to keep the y/y increases in this category elevated whilst the prospect of further tariff hikes are still on the table.

rate of **6.5%** y/y (6.9% y/y in September).

The increase in **Household operation** costs accelerated to **12.3%** y/y (**11.8%** y/y in September), pushed higher by a 23.5% y/y surge in household consumables and a 8.1% y/y rise in the wage of domestic workers.

Percentage change Y/Y

Item	CPI	CPIX
Food	16.7%	17.2%
Transport	17.5%	16.1%
Fuel and Power	29.7%	28.3%
Housing	7.9%	6.5%
Total	**12.1%**	**12.4%**

The following contributed to the major indices during October Y/Y:

Item	CPI	CPIX
Food	4.0	4.9
Transport	2.6	2.4
Housing	1.6	0.8
Fuel and Power	1.1	1.2
Other	2.8	3.1
Total	**12.1**	**12.4**

Outlook:

The slowdown in consumer inflation from the peak reached in August is a very welcome development. The outlook of inflation depends on various factors, as listed below:

<u>The Good:</u>

The **price of oil** has fallen to nearly a third of the US$147 per barrel price it reached in mid-July 2008. The price has been driven down by concerns over international demand as developed economies are expected to contract by 0.3% in 2009 (IMF estimate) and anticipation over slower growth in developing economies continued to mount. The dollar prices of **agricultural food products** (wheat, maize, etc.) have also fallen from their highs recorded earlier this year.

Statistical factors weigh in favour of a lower inflation rate. The **high-base** created during the second half of 2007 will help in lowering the year-on-year price changes towards the end of the year.

The **new inflation basket** to be implemented from January 2009 is also expected to result in a lower rate. (Note that housing will have a weight of 16.4% in the new CPI basket, which will be calculated from rental costs. The latter has increased by 10% - 12% on average this year and could pose some upward risk.)

<u>The Bad:</u>

The factor that is currently threatening lower oil and food prices being given through to the domestic economy is (a cowboy also known as) **the rand**.

International investors have been liquidating their investments in emerging markets, including South Africa, and emerging currencies have come under immense pressure. Fortunately, the dramatic decrease in the oil price is currently outweighing the weakness in the rand and we can expect a **R1.50+ per litre decrease in the petrol price** this Friday, *ceteris paribus*.

<u>The (not so) Ugly:</u>

It is evident that the consumer side of the economy is under significant strain as the wholesale and retail trade, hotels and restaurants sector – directly dependant on **consumer expenditure** – is currently in a recession as shown by the GDP Q3 data released yesterday.

This is very negative with regards to growth, since household consumption is a large driver of domestic production. However, this can be positive for the inflation outlook since lower consumer demand (i.e. capacity) limits the extent with which prices can be given through to the economy and so helps to ‘cap’ inflation pressure.

However, other risks remain. South Africa’s interest rates are higher than most of the world in nominal terms and this has been mentioned as providing scope for aggressive rate cuts. In real terms the picture changes dramatically, since the real repo rate is negative (-0.4%) and the real prime rate is only 3.1%. The country is also faced with a large deficit on the current account, which we expect to come down, though not to the extent that the country would not have to rely on foreign capital for financing the bulk of the shortfall. Private sector credit demand remains on high levels, despite its downwards trend. Our view is that the first rate cut will be given in February.

Prepared by: Doret Els (Economist)

Efficient Group