Investec

27th January 2010

SA Economic Research
CPI Update

Figure 1: SA consumer inflation: history and forecasts

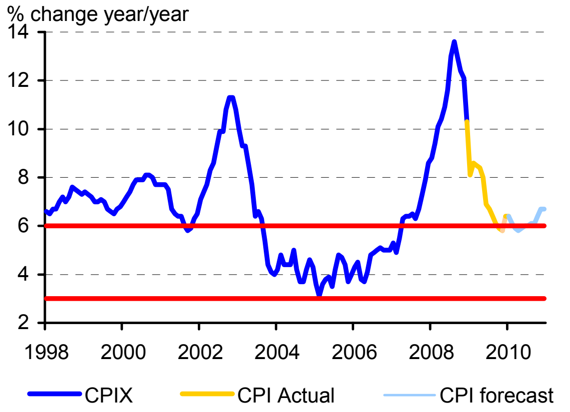


Figure 2: Year/year inflation (%)

	Dec 2009	Nov 2009	Dec 2008	Investec Forecast	Consensus Estimate
CPI	6.3	5.8	10.3	6.1	6.4

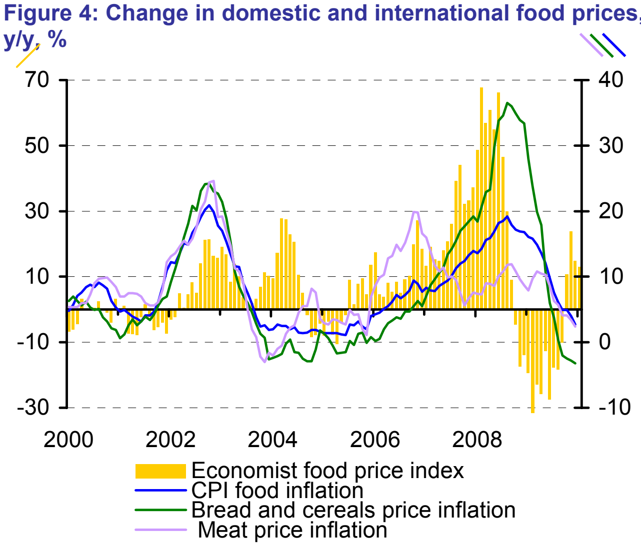
Note: *2008 CPIX

Figure 3: CPI month/month inflation (%)

	Dec 2009	Nov 2009
Housing and utilities	0.1	0.0
Transport	0.1	0.0
Residual	0.1	0.0
Total	**0.3**	**0.0**

CPI: Consumer Price Index.

Figure 4: Change in domestic and international food prices, y/y, %



Sources: Statistics SA

Executive summary:

- CPI inflation left the target range in December, coming out at 6.3% y/y (0.3% m/m), expected 6.4% y/y, due to seasonal and statistical base effects. January's outcome is expected at 6.4% y/y as base effects persist and the usual price increases at the start of the year are instituted;
- Today's outcome does not change our view either in terms of the future path of interest rates or inflation. We believe interest rates will remain unchanged this year, with a possible 50bp hike in October as monetary policy is returned to a more neutral stance, should the strengthening economy warrant it;
- With the demand side of the economy and labour market still in recession, and only likely to emerge from it in early 2010, there is little chance of any interest rate hikes before Q4.10. Even this monetary tightening at the end of the year will be heavily dependent on economic performance and may well be delayed until 2011;
- While the chance of a 50bp cut at the March MPC still remains, it seems that the SARB will keep a close focus on inflation, despite CPI inflation being largely structural in nature (driven by administered prices and other price rigidities). Electricity tariff increases of at least 35% per year would keep inflation CPI inflation out of the target range over most of the forecast period.

Analysis:

Food: Food price inflation continued its downward path in December, despite the seasonal increases in meat prices. Vegetable prices fell by 2.5% m/m and bread and cereals (by -0.3%). The trend in CPI food price inflation follows agricultural food prices, which have been in deflation since March last year. Weak domestic demand and rand strength (lowering the import parity price) continues to keep food price increases muted. Food price inflation is expected to continue its downward path, possibly even turning negative in the coming months before increasing slowly in H2.10.

Transport: Petrol prices on the month rose by 3.7%, adding 0.1% to the monthly total, as petrol prices increased by 27c/litre. Petrol prices declined by 9c/litre in January, which will not exert much pressure on the month, but a rise of around 20c/litre may occur in February, which would contribute to CPI inflation remaining out of target in that period.

Housing and Utilities: Seasonal price increases were recorded for owner's equivalent rent (0.8% m/m) and actual rentals for housing (1.0% m/m)

Outlook

Despite SA experiencing a severe recession in 2008/09, one that has not yet ended in the labour market or likely the demand side of the economy, inflation came out at 6.3% in December. If the statistical base effect which boosted the outcome was removed, CPI inflation would have recorded 6.2% y/y instead, still out of target and still a very high outcome for an economy whose demand side was likely still in recession (or at best weak). In September 2009, CPI inflation was at 6.1%, and HCE (private sector spending) contracted by 2.0% qqsaa. SA's inflation is therefore chronically high, one would have expected a significant lessening in consumer inflation when consumer spending has been in recession for five quarters (since July 2008). Administered (state controlled) price increases, from petrol to electricity, rates and taxes and water to education are keeping inflation high in SA and using interest rates to bring CPI inflation down won't be successful. SA's inflation is largely structural, due both to high administered price increases and other flaws in the SA economy where prices do not respond to higher interest rates (often due to chronic shortages ranging from skills shortages to electricity supply constraints).

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