



Figure 1: SA consumer inflation: history and forecasts

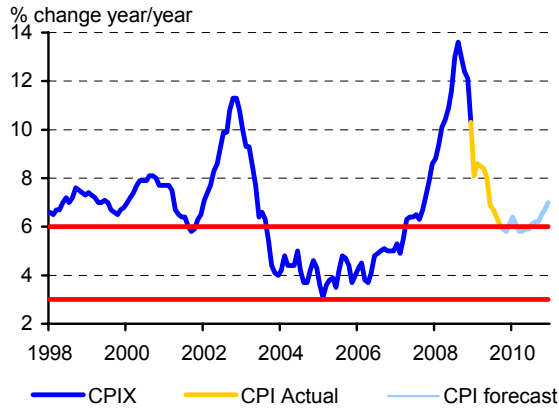


Figure 2: Year/year inflation (%)

	Oct 2009	Sep 2009	Oct 2008	Investec Forecast	Consensus Estimate
CPI	5.9	6.1	12.4	6.0	5.9

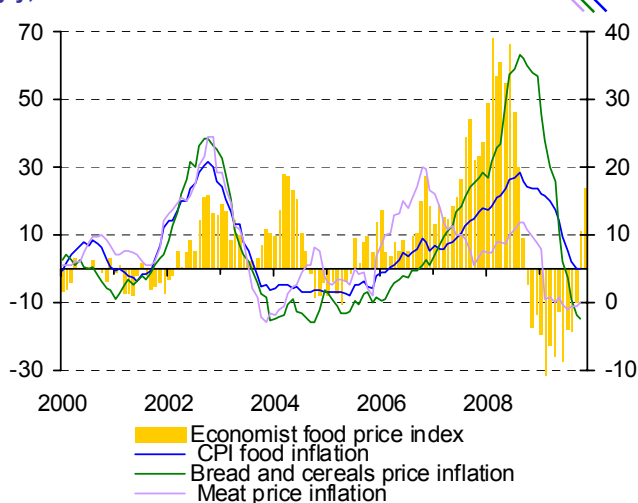
Note: *2008 CPIX

Figure 3: CPI month/month inflation (%)

	Oct 2009	Sep 2009
Food and alcoholic beverages	0.1	
Miscellaneous goods and services		0.1
Housing and utilities		0.1
Transport	-0.2	0.1
Residual	0.1	0.1
Total	0.0	0.4

CPI: Consumer Price Index.

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



Sources: Statistics SA

Executive summary:

- CPI inflation dipped below the target range for the first time since December 2007, to 5.9% y/y (6.1% y/y previously). Although inflation is within target, it is unlikely to remain so over the next six months due to base and seasonal effects;
- The moderation in inflation since the start of the year is reflective of the dire state of the economy. Inflation on the month saw an increase only from the food and alcoholic beverages and the residual category. Food price inflation increases slightly as demand gains momentum toward the festive season. However, prices are unlikely to increase as rapidly as in previous years. Downward pressure came from the transport category, related to the decline in petrol prices on the month;
- The expected gradual global recovery means global inflation will remain low, or near deflation in the first half of 2010, but a sustained rise in commodity prices will prevent longer periods of deflation. SA's short term inflation prospects remain favourable but higher electricity prices over the next three years will keep inflation above the target band;
- The general expectation that inflation will be elevated due to electricity price increases may result in inflation expectations rising sharply, which will mean wage demands and settlements will remain above the target band;
- We expect inflation to hover around the 6% level in coming months and if Eskom's proposed electricity tariff increase of 45% is approved, then inflation will rise sharply in H2.10. Furthermore, such increases will hurt the already fragile economy and could keep growth below potential for a long period of time. If electricity price increases are below 30% (nominal) then inflation could be below target for longer.

Analysis:

Food: Toward year end, food prices tend to rise in anticipation of an increase in demand during the festive season. Meat, vegetable and fruit prices are the most likely to increase but at lower rates than in previous years. Downward price pressure came from the bread and cereals category, with deflation of 0.3% m/m, and likely to fall further on rand strength, which is lowering import-parity pricing, weak domestic demand and international deflation. Overall CPI food inflation has not fallen as rapid as food prices at the producer level despite economic activity being weak.

Transport: Petrol prices on the month declined by 5.1%, subtracting 0.2% from the monthly total, as petrol prices fell by 40c/litre. Petrol prices are expected to remain unchanged in November, which will not dampen the inflation outcome on the month and as such, CPI inflation could move back out of target.

Outlook

Q3.09's GDP outcome (+0.9 qqsaa) and October's inflation falling within target will provide a much needed boost to consumer confidence despite the economy still being weak. While the economy has moved out of recession, we remain cautious about the outlook as domestic demand is still under severe pressure. If global demand remains subdued for long, then there is a risk that the economy could contract for at least one quarter. We expect inflation to remain around the upper end of the target range but high administered price increases next year will raise inflation above the target band. However, the latest GDP and inflation outcomes close the door for any interest rate cuts as the economy is out of recession, but inflation is only marginally, and likely temporarily back in target.



SA Economic Research CPI Update



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