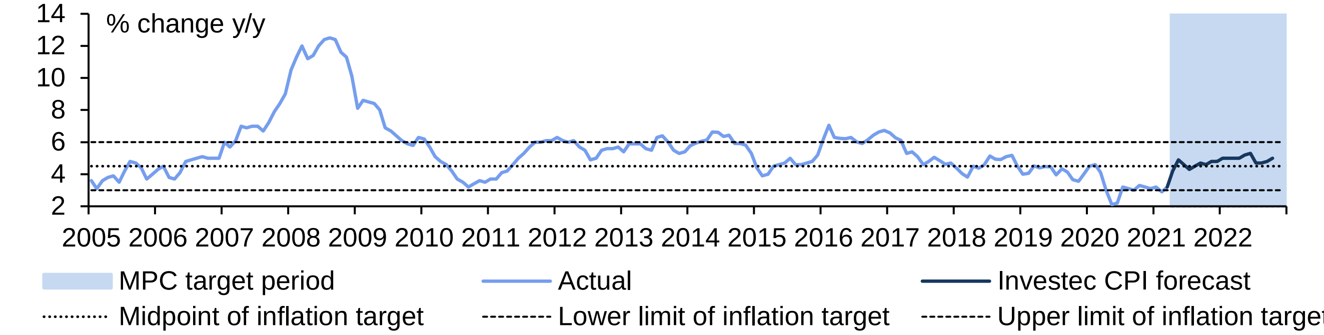
Investec

CPI outlook: Inflation is anticipated to rise on base effects in the very near term, but remain contained within the inflation target in the next five years

Thursday 6 May 2021

Figure 1: SA Consumer Inflation: history and forecasts



Source: Stats SA, SARB, Investec

2020 was an unprecedent year, with the detrimental economic effects of COVID-19 induced lockdowns driving the -7.0% y/y collapse in GDP and drop in inflation, to an average of 3.3% y/y, with levels falling as low as 2.1% y/y in May, the lowest CPI reading since September 2004. A steep decline in fuel prices on plunging oil prices, coupled with depressed domestic demand, supressed the inflation rate for most of last year. Inflation remained relatively subdued during Q1.21, averaging 3.1% y/y, but base effects will push up the CPI reading for the remainder of the year. The BER's Q1.21 inflation expectations survey, released quarterly, sees average inflation rising to 3.9% y/y (previously 4.2% y/y) in 2021 and 4.2% y/y (previously 4.5% y/y) in 2022. All social groups surveyed reiterated a more favourable inflation stance (barring market analysts whose 2021 and 2022 forecasts lifted moderately). Average five-year expectations also edged marginally lower to 4.6% from 4.7% indicated in the preceding survey. The results of the BER's inflation expectations survey, while still indicating a notable lift in the inflation trajectory are below the SARB and Investec's forecasts. Specifically, the SARB while viewing the overall risks to the inflation outlook as balanced, expects inflation to climb to an average of 4.3% and 4.4% in 2021 and 2022, respectively. Investec is anticipating headline CPI to reach an average of 4.2% in 2021 and thereafter increase to an average of 5.0% (2022), above the mid-point of the inflation targeting band, supported by a lift in demand as the global recovery gains momentum. The emergence of new, potentially drug resistant strains of the virus and additional waves of infection remains a risk to the outlook.

Figure 2: Inflation Forecasts

	2020	2021	2022	2023	2024	2025	2026
Consumer Inflation (Av: %)	3.3	4.2	5.0	5.0	5.0	5.0	5.2
(year-end: %)	*3.2*	*4.9*	*5.0*	*5.0*	*4.8*	*5.0*	*5.4*
Producer Inflation (Av: %)	2.5	4.3	4.5	4.5	4.5	4.8	5.0
(year-end: %)	*3.0*	*4.4*	*4.7*	*4.2*	*4.8*	*4.4*	*5.3*
Salary & wage increases (%)	0.9	4.6	5.0	5.1	5.6	6.2	6.4

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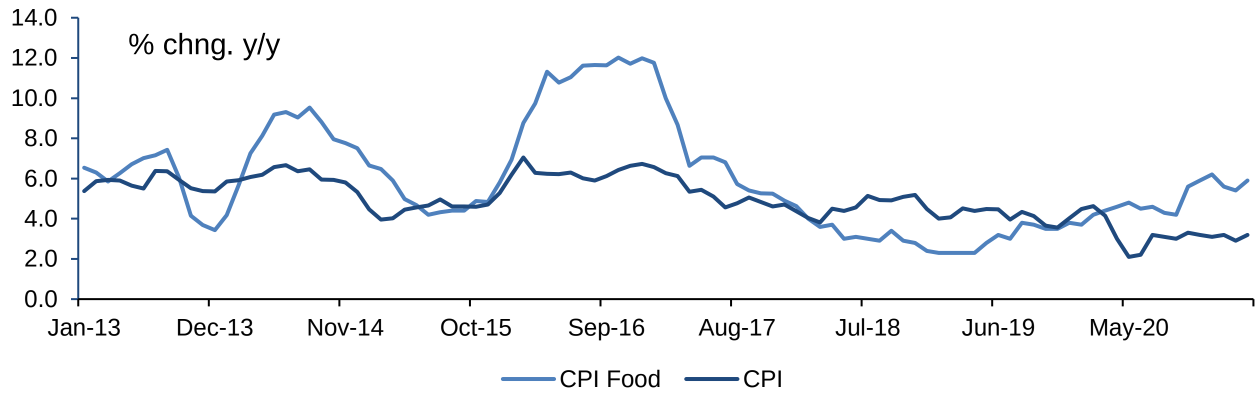
Figure 3: SA Consumer Inflation: Food inflation trend

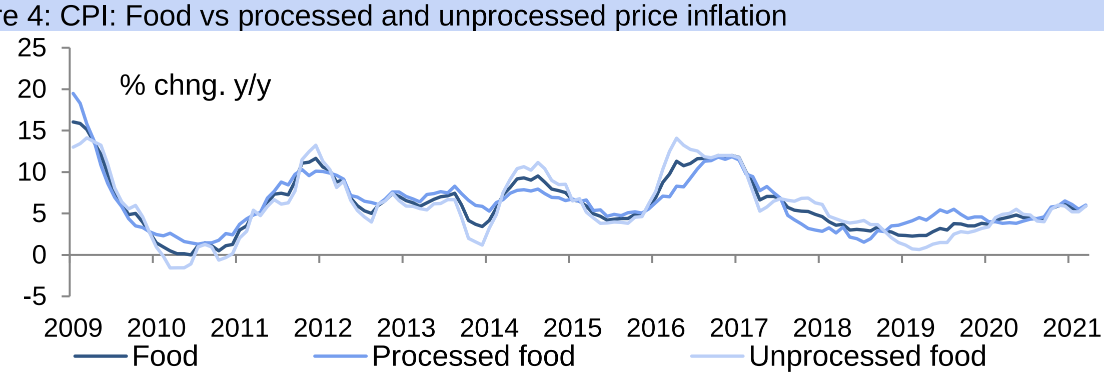


Source: Stats SA, Investec

Food inflation which occupies a marked 15.5% weighting in the CPI basket and thus has a significant bearing on the headline CPI outcome is expected to remain relatively contained this year, averaging around 5.0%, according to Agbiz. While food price inflation has experienced some upward pressure since the turn of the year, on the acceleration in agricultural prices, with grains in particular rising notably since Q4.20, “we could see food price inflation decelerating somewhat,” in Q2.21, according to Agbiz. This will “primarily be underpinned by grain-related products”, with another robust harvest expected for 2020/2021 of around 16.7 million tonnes (Agbiz forecast). Indeed, favorable weather conditions and higher commodities prices “have incentivized farmers to increase plantings in field crops”.

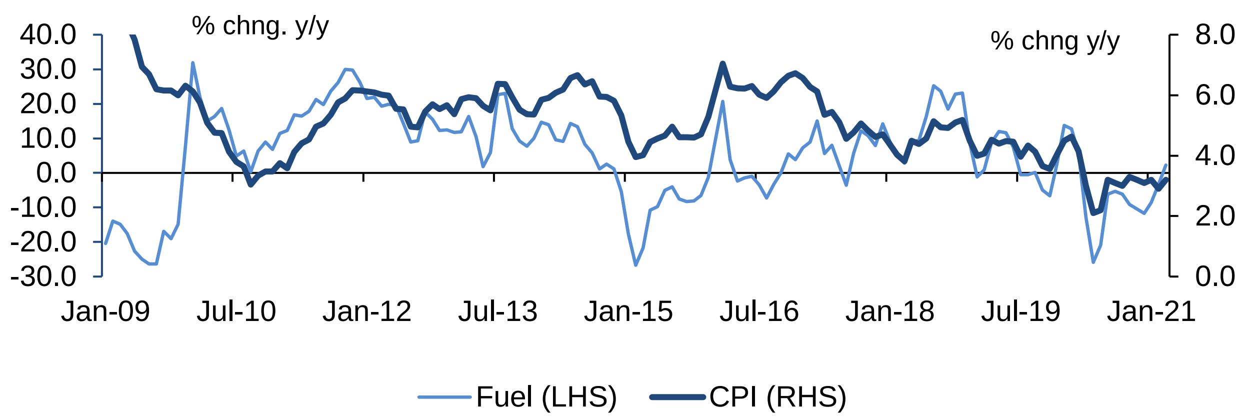
Prices of meat and meat products which also make up a notable share of the food basket are expected to remain relatively flat in the near-term, while oils and fats’ inflation is likely to benefit from the more favourable exchange rate. Additional fuel price hikes however remain a key upside risk, higher fuel prices would push up transport costs and thus final product prices. Specifically, South Africa’s “agricultural commodities and processed food are primarily transported by road”.

Figure 4: CPI: Food vs processed and unprocessed price inflation



Source: Stats SA

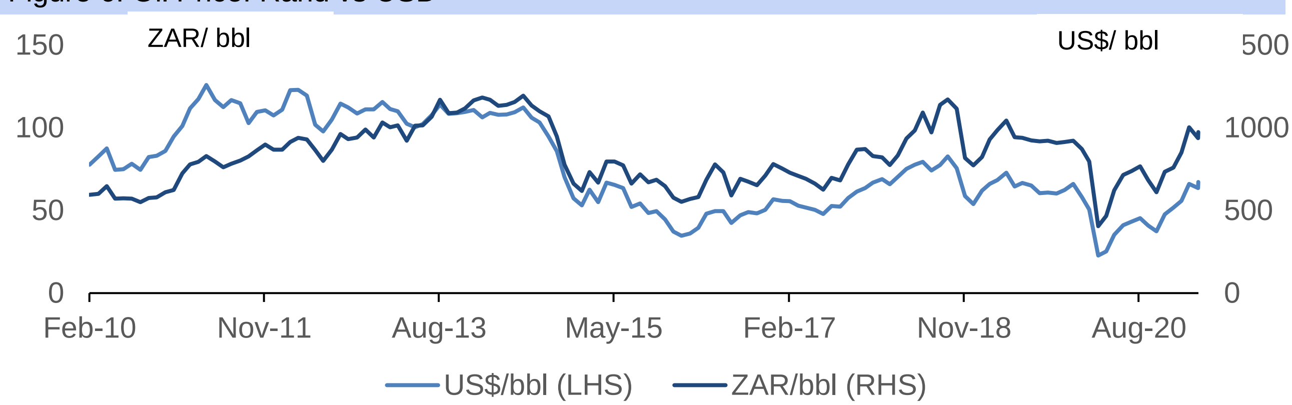
Figure 5: Fuel price inflation vs headline CPI



Source: Stats SA

Market expectations of a global recovery, as well as OPEC's aggressive quotas, has supported the rebound in oil prices from lows seen in Q2.20. Fuel price inflation, which aided the suppression of the headline inflation rate for most of last year has moved out of deflationary territory, this following four consecutive months of marked fuel price hikes. Indeed, petrol prices have risen by a combined 296c/litre since the beginning of the year. May saw the announcement of a welcome fuel price cut, although small, aided by the firmer rand, as the oil price has remained largely stable, averaging around US$66.0/barrel since the beginning of April. Indeed, the domestic currency has gained from the Fed's accommodative monetary policy stance, which has seen financial markets increasingly look to invest in higher yielding assets, with emerging market portfolio assets benefitting from this investment flow, and so emerging market currencies. Additionally, the rand, as a commodity currency has benefitted from the lift in commodity prices, particularly metals. While the domestic currency has appreciated notably from levels recorded last year, it still remains an upside risk to the inflation trajectory as it is highly sensitive to political developments and policy settings both domestically and globally.

Figure 6: Oil Price: Rand vs USD



Source: Bloomberg, Investec

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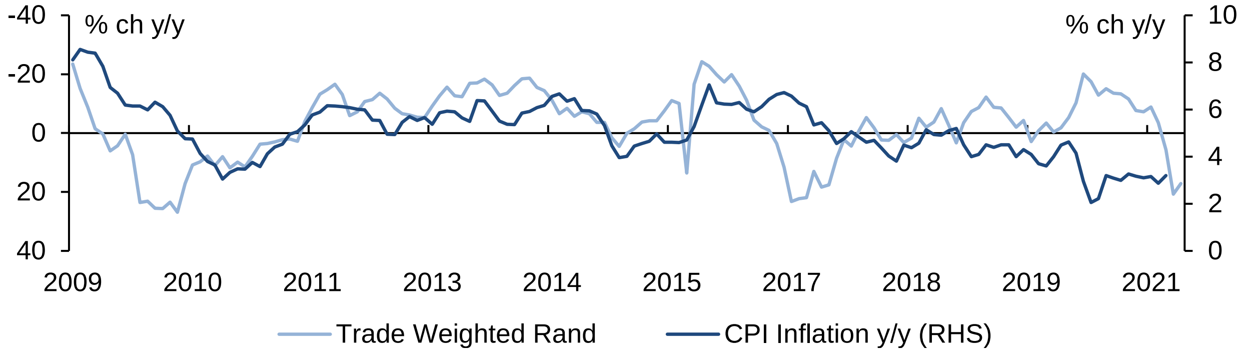
Figure 7: Trade weighted rand movements vs CPI inflation (both % change y/y)

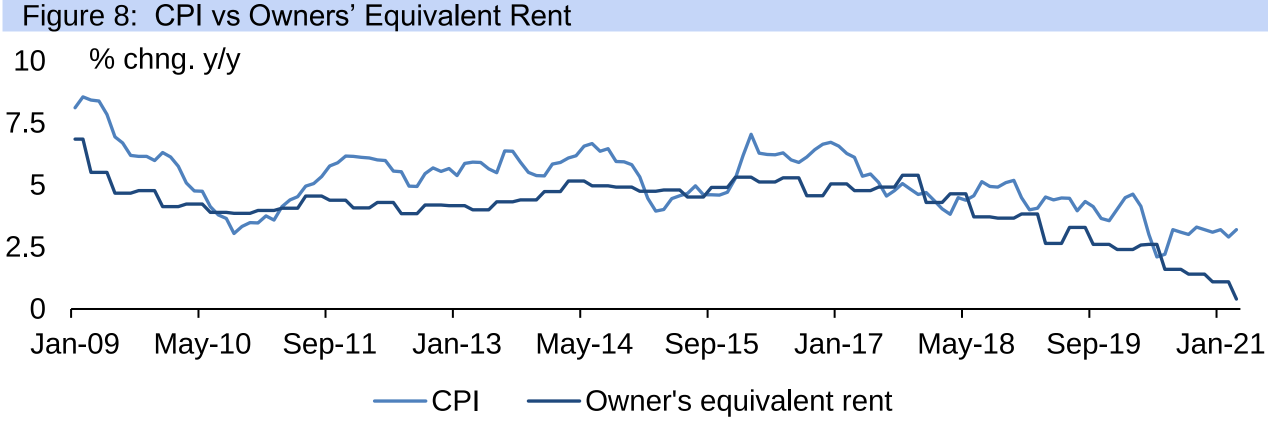


Source: Stats SA, Iress

Looking further ahead, renewed risk aversion in world markets, if key risks to the global growth outlook materialise (including new, drug resistant strains of the virus), would leave the rand vulnerable to potential significant outflows. Additionally, further credit rating downgrades remain a significant risk for the currency over the forecast period. In the near term, both Moody's and Fitch have South Africa on a negative outlook, which infers that the next move in an eighteen month to two year period from each of the respective agencies credit ratings on SA's long-term sovereign debt will be a downgrade. While in our base case scenario we do not anticipate a downgrade at the forthcoming country reviews, the rating agencies are expected to monitor the fiscal climate very critically to see if SA's planned debt and deficit projections can be achieved.

In general, headline CPI inflation in SA is also largely driven by the housing and utilities category (electricity and water, municipal rates and taxes and other housing costs), which makes up just under 25% of the index, and this will likely remain the case over the next several years. Aggregate actual rentals and owners' equivalent rent inflation has slid to the sub 1.0% y/y levels from the most recent high of 5.5% y/y in 2017, in turn having a dampening effect on the headline CPI reading. Specifically, while residential property demand has picked up, supported by low interest rates and a shift to a work-from-home culture, exacerbated by the pandemic, rental demand has eased materially.

Figure 8: CPI vs Owners' Equivalent Rent



Source: Stats SA

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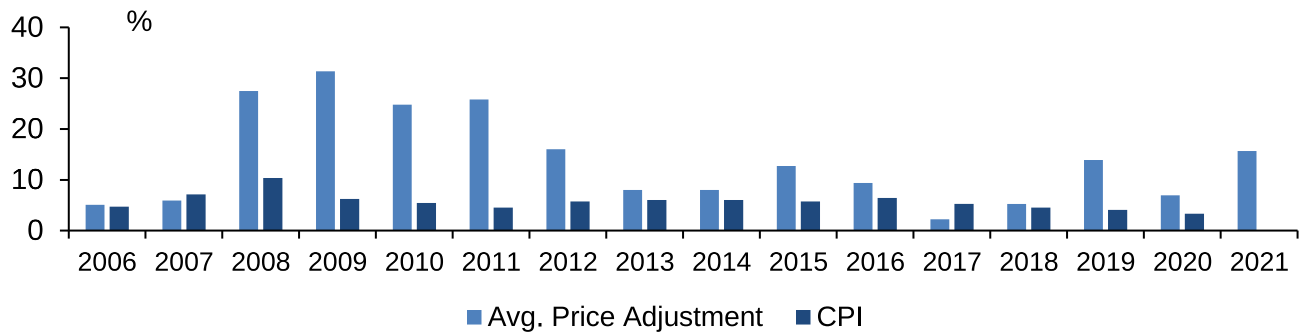
Figure 9: Average electricity price increases vs CPI



Source: Eskom. Stats SA

Electricity and water price hikes remain upside risks to the inflation trajectory for the entire five-year forecast period as well and are measured in the month of July each year. Following a relatively modest 6.9% tariff increase granted to Eskom by the National Energy Regulatory last year, a high court ruling on the 16 February saw Eskom increasing average tariff prices by 15.63% for the 2021/2022 financial year, as such, the annual contribution from the electricity component to headline CPI is likely to lift. Eskom, which supplies electricity to most of the country has a mounting debt burden and is a major risk to the country's fiscal position and sovereign credit rating. Indeed, Eskom's electricity price increases have exceeded CPI for over a decade, with reliable, cost effective electricity supply essential to the optimal functioning of the economy. At Eskom's State of the system briefing in March, the CEO reiterated that "there will continue to be an electricity supply shortfall of approximately 4,000MW over the next five years". Continued operational challenges, elevated borrowing costs, the inability to retrieve billions owed by municipalities and ongoing vandalism of infrastructure is likely to plague Eskom for years to come. Consequently, notable tariff hikes are likely to continue, further eroding household disposable incomes.

The expected higher trend in CPI inflation from this year out to 2026, and indeed even following on from there, will be underpinned by higher administered price pressures as well as growing demand premised on the strengthening of global and domestic growth as the vaccine rollout gains momentum. Indeed, we are anticipating inflation to average 5.0% between 2022 and 2025, accelerating slightly thereafter to 5.2% in 2026. While this is our base case prediction and is supported by the upwardly revised global growth forecasts of the IMF as well as recently published high frequency data indicators, risks remain. Specifically, mutant strains of the virus, accompanied by additional waves of infection would undermine this scenario, both this year and over the forecast period.

Figure 10: Inflation expectations – Q1.21 survey results

	2021	2022	2023
Financial Analysts	4.1	4.4	4.4
Business	4.0	4.4	4.7
Trade Union Movement	3.6	3.9	4.2
Average	**3.9**	**4.2**	**4.4**

Source: BER

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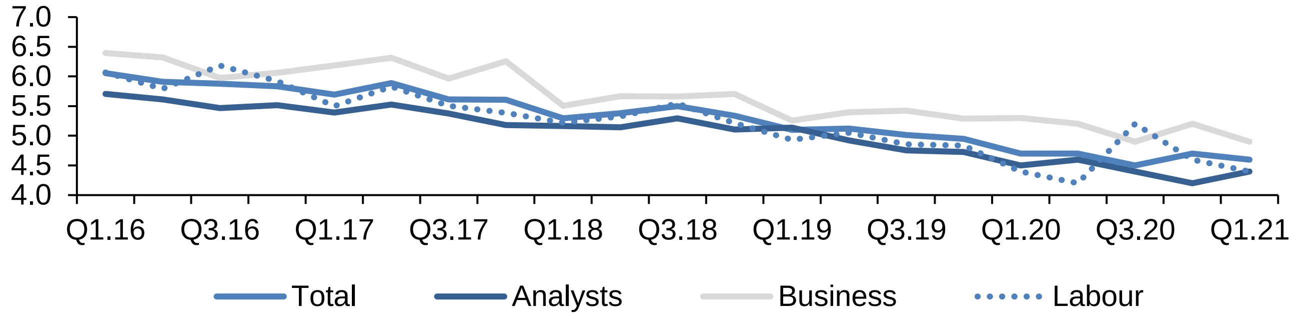
Figure 11: Average Inflation Expectations over the next five years



Source: BER

Figure 12: Quarterly Inflation Forecasts

	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4	2022 Q1	2022 Q2	2022 Q3	2022 Q4
Consumer Inflation (Av: y/y %)	4.4	2.4	3.1	3.2	3.0	4.5	4.5	4.8	5.1	5.2	4.8	5.0
Producer Inflation (Av: y/y %)	4.2	0.7	2.3	2.9	3.8	5.1	4.3	4.3	4.4	4.3	4.5	4.6
Salary & wage increases (y/y %)	4.4	-2.6	1.0	1.0	2.8	6.2	5.5	4.0	4.7	5.3	4.6	5.3

Source: Statistics SA, SARB, Investec

Figure 13: Quarterly Inflation Forecasts

	2023 Q1	2023 Q2	2023 Q3	2023 Q4	2024 Q1	2024 Q2	2024 Q3	2024 Q4	2025 Q1	2025 Q2	2025 Q3	2025 Q4
Consumer Inflation (Av: y/y %)	5.0	4.9	5.2	5.1	5.0	5.2	5.0	4.7	5.2	5.0	5.0	4.9
Producer Inflation (Av: y/y %)	4.5	4.5	4.6	4.4	4.1	4.6	4.6	4.7	5.1	4.9	4.8	4.5
Salary & wage increases (y/y %)	5.2	5.4	5.0	5.0	5.1	5.4	5.7	6.1	6.2	6.2	6.2	6.2

Source: Statistics SA, SARB, Investec

Figure 14: Quarterly Inflation Forecasts

Inflation forecasts	2026 Q1	2026 Q2	2026 Q3	2026 Q4
Consumer Inflation (Av: y/y %)	5.0	5.4	5.1	5.3
Producer Inflation (Av: y/y %)	4.7	5.0	4.9	5.2
Salary & wage increases (y/y %)	6.3	6.3	6.5	6.6

Source: Statistics SA, SARB, Investec

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Figure 15: CPI forecast averages

Date	Index Base 2016	Annual y/y	Monthly m/m	Quarterly y/y	Calendar year y/y	
Jan 2019	109.2	4.0	-0.2			
Feb 2019	110.1	4.1	0.8			
Mar 2019	111.0	4.5	0.8	4.2		
Apr 2019	111.7	4.4	0.6			
May 2019	112.0	4.5	0.3			
Jun 2019	112.4	4.5	0.4	4.4		
Jul 2019	112.8	4.0	0.4			
Aug 2019	113.1	4.3	0.3			
Sep 2019	113.4	4.1	0.3	4.1		
Oct 2019	113.4	3.7	0.0			
Nov 2019	113.5	3.6	0.1			
Dec 2019	113.8	4.0	0.3	3.7	2019	4.1
Jan 2020	114.1	4.5	0.3			
Feb 2020	115.2	4.6	1.0			
Mar 2020	115.6	4.1	0.3	4.4		
Apr 2020	115.0	3.0	-0.5			
May 2020	114.3	2.1	-0.6			
Jun 2020	114.9	2.2	0.5	2.4		
Jul 2020	116.4	3.2	1.3			
Aug 2020	116.6	3.1	0.2			
Sep 2020	116.8	3.0	0.2	3.1		
Oct 2020	117.1	3.3	0.3			
Nov 2020	117.1	3.2	0.0			
Dec 2020	117.3	3.1	0.2	3.2	2020	3.3
Jan 2021	117.7	3.2	0.3			
Feb 2021	118.5	2.9	0.7			
Mar 2021	119.3	3.2	0.5	3.1		
Apr 2021	119.8	4.2	0.4			
May 2021	119.9	4.9	0.1			
Jun 2021	120.1	4.6	0.2	4.5		
Jul 2021	121.5	4.3	1.1			
Aug 2021	121.8	4.5	0.3			
Sep 2021	122.2	4.7	0.4	4.5		
Oct 2021	122.5	4.6	0.2			
Nov 2021	122.7	4.8	0.2			
Dec 2021	123.0	4.8	0.2	4.8	2021	4.2

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Figure 15: CPI forecast averages

Date	Index Base 2016	Annual y/y	Monthly m/m	Quarterly y/y	Calendar year y/y	
Jan 2022	123.6	5.0	0.5			
Feb 2022	124.5	5.0	0.7			
Mar 2022	125.2	5.0	0.6	5.0		
Apr 2022	125.7	5.0	0.4			
May 2022	126.1	5.2	0.3			
Jun 2022	126.5	5.3	0.3	5.1		
Jul 2022	127.2	4.7	0.6			
Aug 2022	127.6	4.7	0.3			
Sep 2022	128.1	4.8	0.4	4.8		
Oct 2022	128.6	5.0	0.4			
Nov 2022	128.9	5.0	0.2			
Dec 2022	129.1	5.0	0.2	5.0	2022	5.0
Jan 2023	129.8	5.0	0.5			
Feb 2023	130.6	4.9	0.6			
Mar 2023	131.5	5.0	0.7	5.0		
Apr 2023	132.0	5.0	0.4			
May 2023	132.3	4.9	0.2			
Jun 2023	132.5	4.8	0.2	4.9		
Jul 2023	133.9	5.2	1.0			
Aug 2023	134.3	5.2	0.3			
Sep 2023	134.8	5.2	0.4	5.2		
Oct 2023	135.2	5.1	0.3			
Nov 2023	135.5	5.1	0.2			
Dec 2023	135.6	5.0	0.1	5.1	2023	5.0
Jan 2024	136.3	5.0	0.5			
Feb 2024	137.1	5.0	0.6			
Mar 2024	138.1	5.0	0.7	5.0		
Apr 2024	138.8	5.1	0.5			
May 2024	139.2	5.2	0.3			
Jun 2024	139.5	5.2	0.2	5.2		
Jul 2024	140.6	5.0	0.8			
Aug 2024	141.0	5.0	0.3			
Sep 2024	141.4	4.9	0.3	5.0		
Oct 2024	141.6	4.7	0.1			
Nov 2024	142.0	4.8	0.3			
Dec 2024	142.1	4.8	0.1	4.7	2024	5.0

Source: Stats SA, Investec

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