Investec

SA Economics

Oil Note

Thursday 28 May 2020

After falling each month this year, the petrol price in now set for an around R1.16/litre hike in June, on the back of the substantial rise in the Brent crude oil price this month, with further upwards pressure likely

- The oil price has risen sharply so far this month, from US$19.33/bbl in April to US$36.17/bbl in May for Brent crude. The near doubling is currently estimated to push up the petrol price by R1.16/litre in June, a likely unexpected increase for many, with many believing that oil prices, and inflation would stay low this year instead.

- Recent rand strength, with the domestic currency reaching R17.30/USD today, has been insufficient to counterbalance the sharp rise in the oil price. The movement in the exchange rate so far only indicates a 6c/litre cut, in the face of a R1.22/litre hike in the petrol price signalled by the jump in oil prices.

- A R1.16/litre hike adds around 0.5% to CPI inflation, exerting upwards price pressure on June's CPI inflation after the petrol price declined in the first five months of this year. To end May this year, the petrol price fell by -R4.08/litre, a primary reason for the falls in CPI inflation to 4.1% in March, likely to 3.5% y/y in April and closer to 3.0% y/y in May.

- June's petrol price increase, should it materialise, would push CPI inflation back towards the 3.5% y/y mark in that month, and further petrol price hikes, which are not unlikely in coming months, would see CPI inflation returning to 4.0% y/y, then potentially exceeding it. Base effects for higher inflation last year have also suppressed CPI inflation this year.

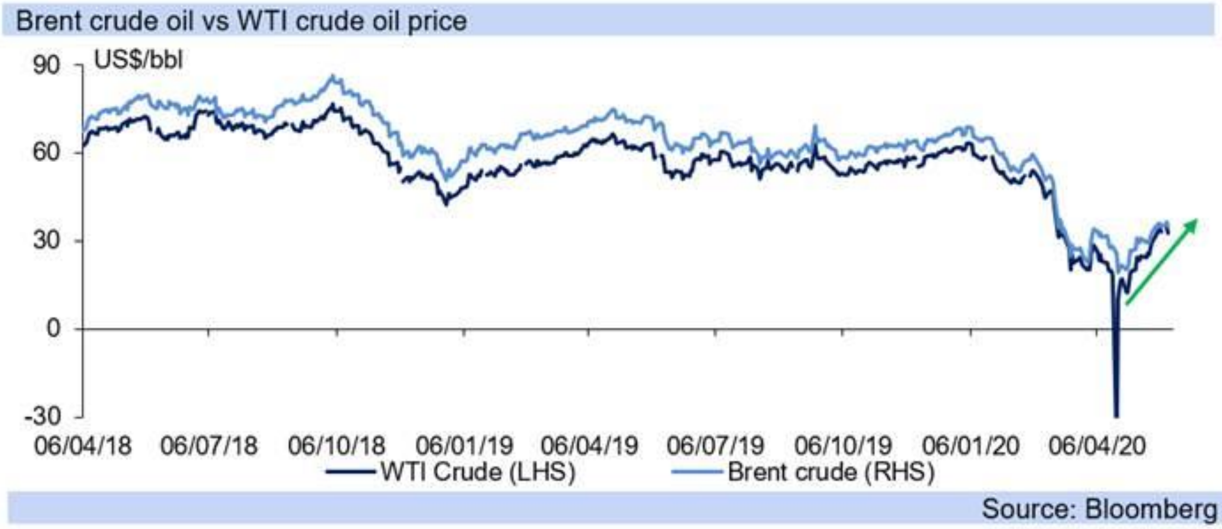
- However, also key to note on SA's inflation front, is that Q2.20 will see substantial changes to the calculation of CPI, as the extreme lockdown of the economy, particularly in May, has made it impossible to collect the bulk of the data needed for April's publication. The publication date for April's CPI inflation figure has been moved from today to 24th June.

- Statistics SA says that only 20% of prices in the weighted CPI basket (171 products) were collected for April online, but 42% of the basket was not collected, and a further 27% will have to be imputed as they are not necessarily available either. The remaining 12% was collected as usual from an official or administered source, such as the petrol price.

- Statistics SA plans to impute prices for goods/services where no consumer expenditure occurred (due to the lockdown) in April. The prices for these banned goods (such as alcohol and tobacco, clothing and footwear, most household contents and housing maintenance and repair for example) could be based on others or carried over from March.

- With the lockdown still in effect for many goods and services over May, and in limited effect in June, the calculation of inflation for these two months will also be affected. There is likely to be disinflation pressure from fuel and essential goods/services prices on the whole in May, but this will lessen in June and fuel prices will exert strong upwards pressure.

- The huge rally in oil prices has been aided by the market expectations of global recovery increasingly being in sight as lockdowns ease around the world. Cuts in oil production have also been key in supporting prices, with Russia and Saudi Arabia seeing an end to their spat earlier in the year, and demand has increased as lockdowns actually ease.



- While the increase in consumption as lockdowns have eased around the world, and the rise in business activity has aided demand for oil, it is still well off pre-Covid19 levels. The recent drawdown in US inventory proved larger than expected, supporting the WTI (West Texas Intermediate) oil price temporarily, but it is not a trend.

- Uncertainty is still a prevailing factor around the recovery, while different areas of oil production around the world are experiencing different levels of disruption from Covid-19, and the recovery will likely be patchy. For oil prices, this indicates some potential for further upside, but it is also likely that their recovery will be sporadic over the rest of this year.

- Supply factors will also be key, with the recent OPEC+ production cuts substantial but crude oil stockpiles are also building up in some areas. Oil prices are likely to be choppy in the next few weeks, with retracements from gains, and the risk remains of a much steeper fall should market expectations of global economic recovery falter.

- If the economic downturn globally proves less (or more) severe than expected this will also move oil prices. Longer-term however oil prices are expected to move up by the end of this year, and into next, supporting inflation globally. The risk would be for the downside instead, if Covid-19 infections rise, or second multiple/waves develop, heightening lockdowns.

- Most recently US stockpiles saw a substantially greater increase than expected, negatively impacting WTI pricing, while risks to the downside for another price war on renewed tensions between Russia and Saudi Arabia on production cuts are also seen, as is excess production running into storage constraints again.

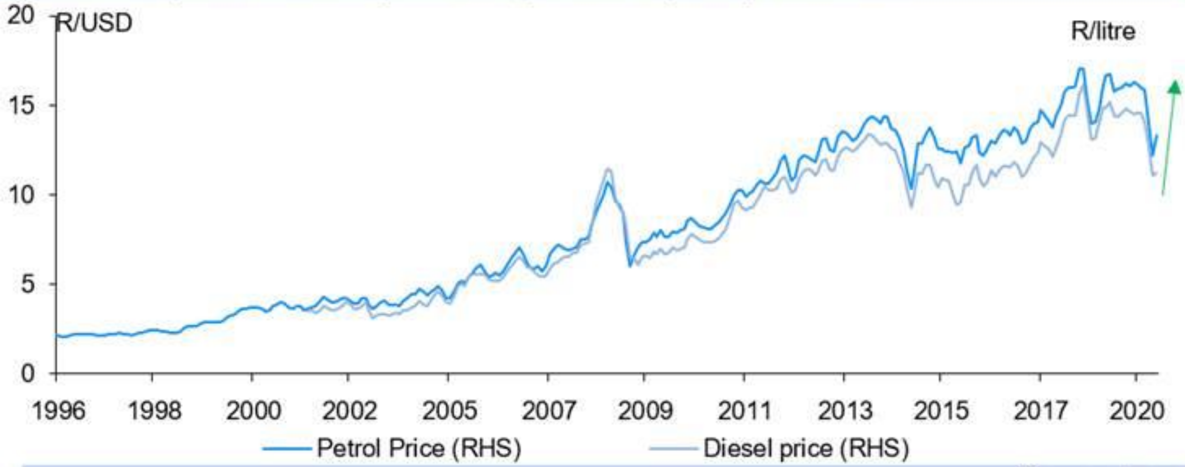
- The likely choppy nature of the oil price for the remainder of this year will reflect its attempted stabilisation. The shock to the global economic system from Covid-19 has been extreme, and so the recovery will most likely include substantial moves in either direction. The global supply chain is still dislocated and recovery this year is not certain yet.

- The shock to economic growth this year will far exceed the economic impact of the 2008/09 financial crisis, or Great Recession. It will also exceed the economic impact of most other financial crises, and is being likened to the Great Depression of the 1930’s in terms of its immediate impact, but is also not expected to last anywhere near as long.

- In South Africa, weak demand for goods and services will exert a moderating effect on prices, but already in the first two weeks of April 27% of businesses said that prices for supplies (materials, goods and/or services) where applicable, increased by more than normal. In the second two weeks of April 44% said input prices were rising by more than normal.

- Statistics SA has not, unfortunately, released a further survey on the business impact of the Covid-19 pandemic in South Africa, but the lockdown constraints still in existence in many areas in May will have seen some shortages of inputs into the supply chain (particularly imports), adding to upwards price pressure from these sources.

Rand versus petrol and diesel prices – oil price rise to push up fuel costs



Source: Iress