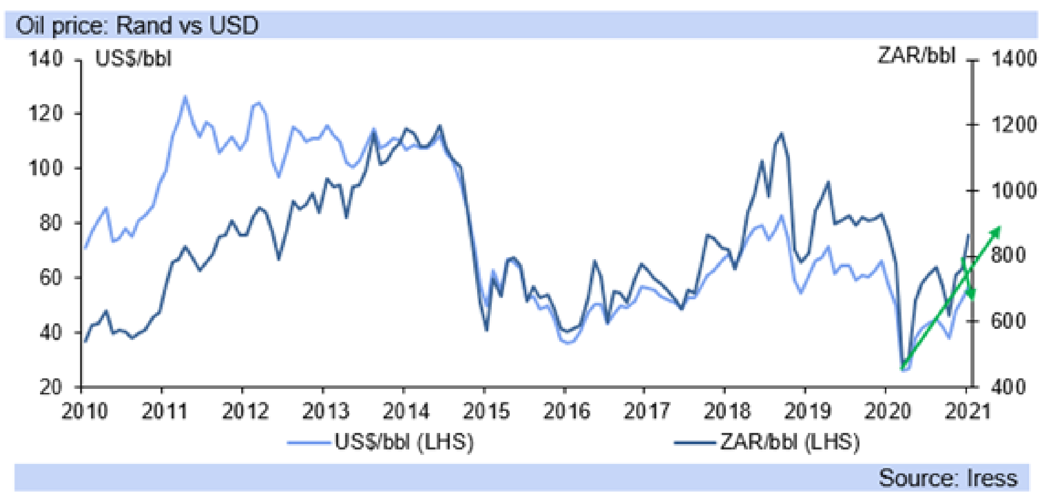
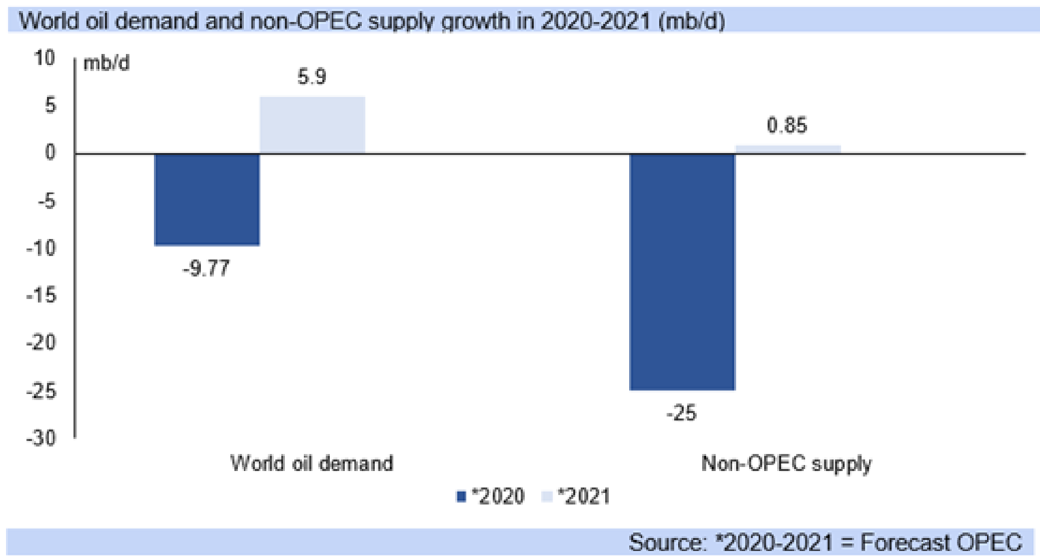
Investec | Out of the Ordinary

SA Economics

Wednesday 13 January 2021

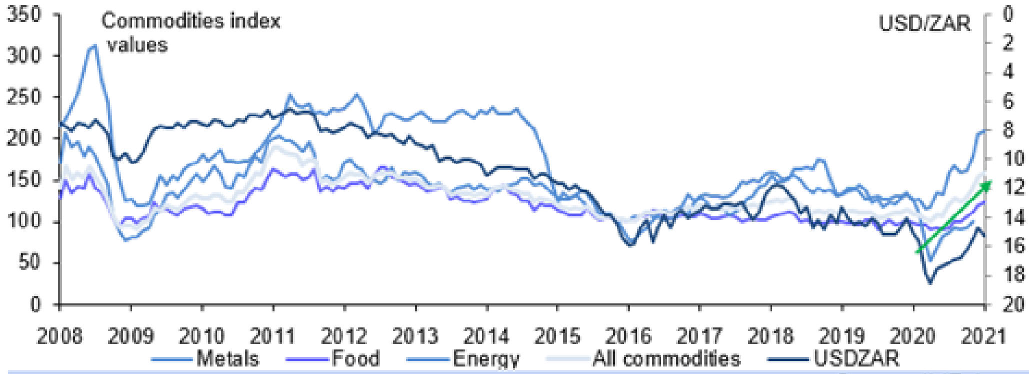
Oil note: rising oil prices have placed upwards pressure on SA's fuel prices so far this year and CPI inflation could lift by more than expected, with the rand likely to remain volatile and so not provide much countervailing force





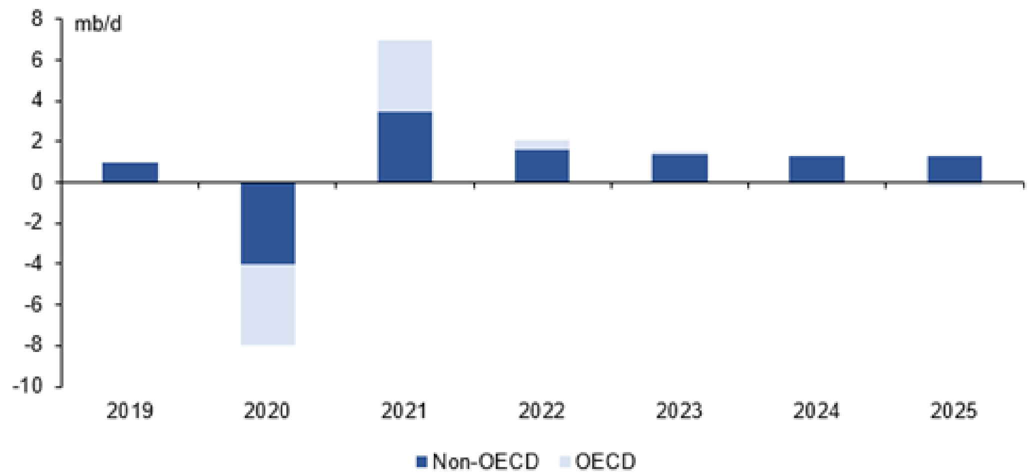
- South Africa saw a petrol price increase of 40c/litre in January, and another of closer to R1 is currently scheduled for February, and if it transpires, would exert substantial upwards price pressure on CPI inflation, more than has been generally expected for the first quarter.
- The rise in the oil price has been the key driver of the upward pressure in fuel prices in January, and is driving a likely substantial increase in February too, as oil prices have jumped to US$56.7/bbl from US$47.4/bbl at the start of December for Brent spot.
- The strength of the rand in December shielded SA from a larger rise in fuel prices, with the domestic currency strengthening from R15.47/USD at the end of November 2020 to R14.69/USD by the end of December, but then weakened over most of January 2021.
- The rand has reached R15.18/USD today, boosted yesterday to R15.21/USD by further renewed appetite for SA bonds from foreigners, who made net purchases of R2.7bn after buying R0.4bn on Monday, and after spending the first week of November dumping SA debt.
- The volatility of financial markets has a substantial impact on SA's fuel prices, and so on its inflation rate, with CPI inflation expected to average 4.2% y/y this year, from 3.3% y/y last year, boosted by statistical base effects, and at risk from rand weakness and higher oil prices.
- In rand terms, the oil price rose by over R100/bbl as it lifted from R740.57/bbl at the end of November, to R861.89/bbl currently, driven higher mainly by the increase in international oil prices on Saudi Arabia production cut plans and Asian demand rises on a harsh winter.
- The EIA (the US Energy Information Administration) forecasts that Brent crude oil spot prices will average US$53/bbl in both 2021 and 2022, compared to the average of US$43/bbl in 2020, but warns of heightened uncertainty still caused by the pandemic this year.
- International, and even domestic, travel is not expected to return to pre Covid-19 levels before H2.21 at the very earliest, but more likely in 2022, depending on the vaccine rollout globally. Global economic recovery is likely to remain uneven, and the oil price volatile this year.
- Low inflation in 2020 was driven by low oil prices and recession in South Africa, and this is not expected to persist in 2021, while base effects from the inflation lows reached last year will exert significant upwards pressure on CPI this year.

Commodities price indices vs rand



Source: IMF, Iress

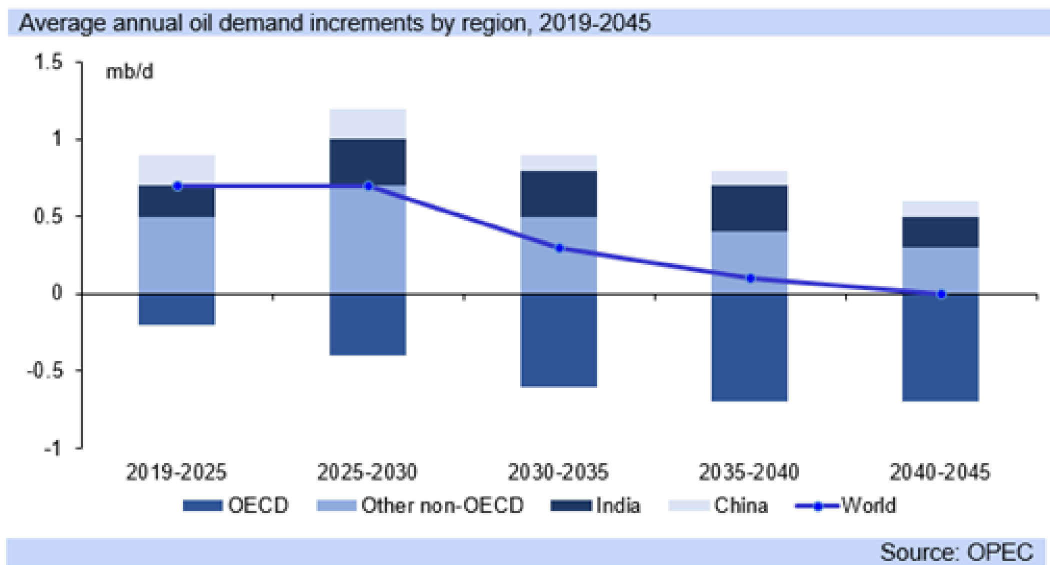
Annual oil demand increments by region 2019-2025



Source: OPEC

- South Africa's petrol price fell in the main over 2020, ending last year close to R2 lower, at R14.46/litre, than at the end of 2019, and suppressing the effect on inflation over the period, an effect which is dulling this year so far, with the year barely begun.
- .The petrol price is already back at levels it was in October 2020, and if the price increase of around 74c/litre goes ahead in February, then the price of petrol would be nearing levels of March last year, reversing most of the dampening fuel price effects on domestic inflation.
- The strengthening of the global recovery, particularly in the second half of this year, along with the lift in commodity prices, will also support inflation, while the rand has pulled back from recent heavily overbought levels at the start of the year, it will likely remain volatile.
- The rand cannot be relied upon to provide much of a countervailing force to higher oil prices as the key energy commodity sees an elevated level compared to last year's suppressed average value, with key OPEC producers already proving proactive on the pricing front.
- OPEC highlights that last year, "together with the non-OPEC oil-producing countries in the Declaration of Cooperation (DoC), … (it) undertook the largest and longest production adjustments in the oil industry's history, initially amounting to nearly 10% of global output".

- "Building on more than three years of a tested and proven framework for cooperation, this bold and decisive action helped arrest the market's freefall, supported the draw-down of unsustainable inventory levels and boosted market confidence."
- OPEC is unlikely to flinch in engendering support for oil prices in 2021. Looking further afield however as it extends its forecast out to 2045, the organisation recognises the likely declining demand for oil in the face of efforts globally to combat climate change.
- Adding, "(p)olicy instruments that primarily target objectives of the Paris Agreement will continue to drive a transition to renewable energy sources and a reduction in greenhouse gas (GHG) emissions". This is likely partially true as Trumps tenure ends.
- "Policies relating to energy demand and supply are expected to become more stringent over the forecast period" … with "many countries … signed up to a global, collective effort to combat climate change".



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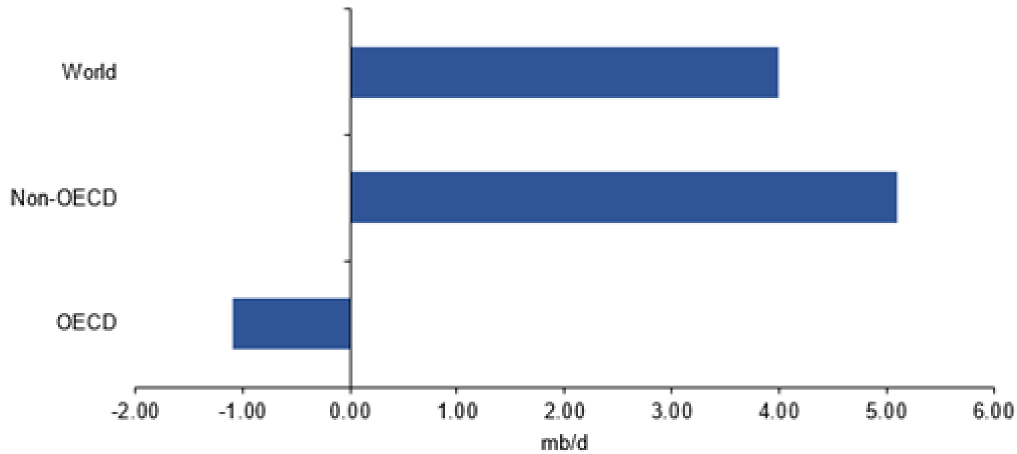

Source: OPEC