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Consumer price inflation down in December despite higher food prices

Highlights

- South Africa's consumer price inflation rate averaged 3.3% in 2020, down from 4.1% in 2019.
- December's year-on-year (y/y) inflation rate edged down to 3.1% from 3.2% in November.
- Month-on-month inflation rose by 0.2%, higher than the 0% in November.
- The main drivers behind December's monthly increase were food and transport prices, while food, non-alcoholic beverages and utility prices contributed most to the y/y increase.
- Core inflation remained unchanged at 3.3% y/y.
- The consumer price inflation rate is expected to increase gradually in 2021 and 2022, putting pressure on the repo rate to rise in the second half of this year to keep inflation around the midpoint of the 3% to 6% target band.

Higher food and utilities inflation kept December's inflation rate above 3%

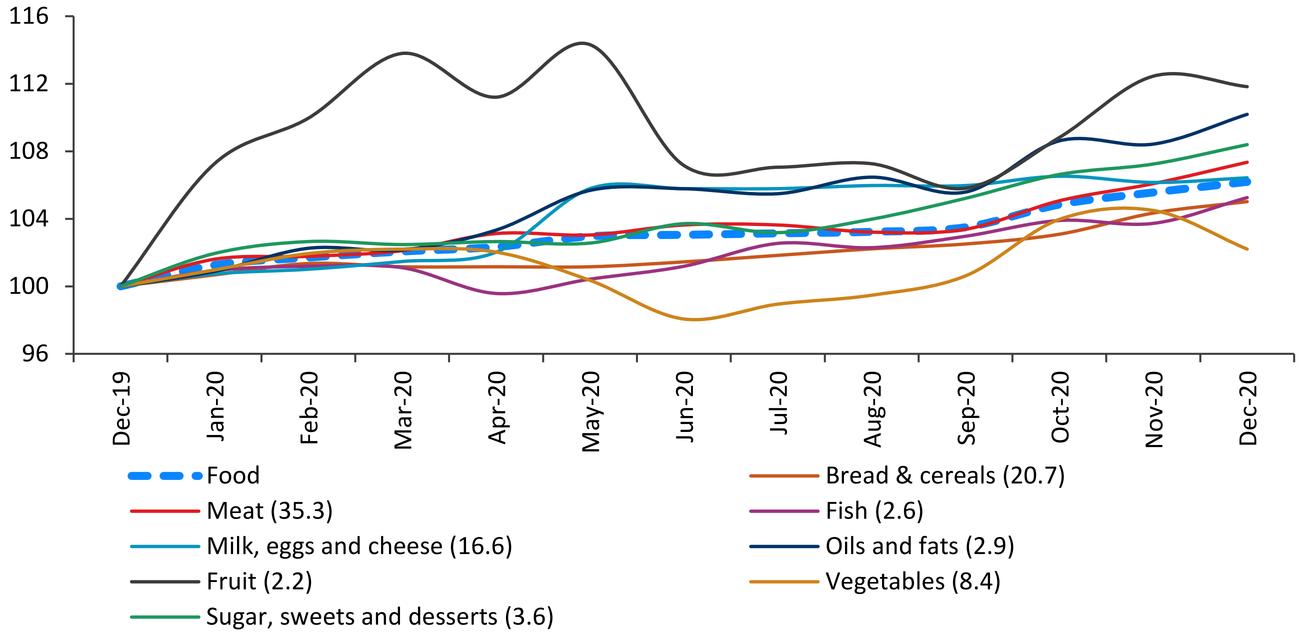
The consumer price inflation (CPI) rate declined in December to 3.1% year on year (y/y) from 3.2% in November. December was the 45th consecutive month that CPI was below 6%, which is the upper level of the target band. It was also the 24th time that it was below the 4.5% mark the South African Reserve Bank (Sarb) is targeting. This might create the impression that South Africa is moving to structurally lower CPI. However, these numbers were registered in an environment of weak demand. As such, a judgment can only be made if the same results can be achieved in a high-demand environment.

Food prices increased from 5.9% y/y in November to 6.2% in December. The monthly increase was 0.6%.

Meat and bread (which have large weightings in the food price basket) continued their upward pressure on food price inflation (see figure 1). These two items increased by 7.3% and 5% respectively, up from 6.6% and 4.2% in November. Together with fruit prices, which were 11.8% higher than a year ago, and that of oils and fats, which increased by 10.2%, it made sure food prices breached the 6% level for the first time since August 2017.

Utility prices such as water and electricity averaged 6.6% and 9% respectively in 2020. This was to some degree neutralised by fuel prices that were 6.4% lower compared to 2019.

Figure 1: Meat and bread prices driving food price inflation in 2021 (weightings of items in food price basket in brackets)



Sources: Stats SA, Momentum Investments

Consumer price inflation is expected to increase in 2020 and 2021

At this stage, CPI is expected to average 3.9% in 2021 and 4.7% in 2022, which is somewhat higher than the 3.4% registered in 2020. As the inflation-targeting framework requires the Sarb to be forward looking, the upward trend will increase the pressure on the Monetary Policy Committee to increase the repo rate during the latter part of the year.

Table 1 shows that the weightings of the items in the CPI basket, which are expected to exert upward pressure on CPI during 2021, exceed those expected to contribute to downward pressure. Some pressures are expected to be temporary, while others are more permanent. A low base registered in 2020 will also add pressure on CPI to increase.

Food prices should initially continue its increasing trend, driven by higher bread and meat prices, which is caused by higher input costs such as rising grain prices. However, the Agricultural Business Chamber expects the effect of the elevated grain prices to dissipate after the first quarter of 2021, mainly due to good rainfalls that brought about large harvests. The National Agricultural Marketing Council projects larger supply surpluses for white and yellow maize, as well as wheat in 2021. The Agricultural Business Chamber expects food price inflation of around 5% in 2021.

The bias is for the housing inflation rate to decline. Rental inflation is experiencing downward pressure from an excess supply of rental units. TPN's Rental Vacancy Rate Survey for the fourth quarter of 2020 increased to 12.9%, up from 7.5% in the first quarter of 2020. The increase in the number of vacancies is driven by higher unemployment that decreased the earnings of households. BankservAfrica's Take Home Pay Index for October 2020 revealed that 10% less people received a salary compared to a year ago. In addition, house prices are expected to add to the downward pressure on CPI, due to a supply glut at a time when demand is under pressure. First National Bank's (FNB) House Price Index shows that price increases started to decelerate during the fourth quarter of 2020. FNB expects house prices to, on average, decline by around 6% this year.

Utilities inflation will, however, contribute to higher CPI. A court decision guaranteed Eskom a 10% increase in electricity rates for the next three years up to 2023. However, the increases will be higher, as the normal yearly increases must be added to this. Water and other rates are also expected to increase by more than 6%, as municipalities scramble to recover lost revenue.

Education inflation, which normally increases by 7% to 8%, is expected to increase at a slower rate. Dr Blade Nzimande, minister of higher education, science and innovation, said government will regulate tuition fees to make them more affordable. He called upon tertiary institutions to increase tuition fees by no more than 4.7% and accommodation fees by 6.7%. Primary and secondary fee-based schools are expected to have increased their fees for 2021 by less than the respective average increases of 7.3% and 7.6% (in 2020). Most schools accumulated healthy surpluses due to, among others, lower expenses – for instance, no spending on extramural activities occurred last year.

Transport inflation is bound to increase on the back of higher fuel prices, resulting from an increase in the fuel price levy and international oil prices. The latter should increase in accordance with a recovery in world economic growth.

Contrastingly, medical inflation should increase at a slower pace as medical aid schemes were called upon to implement inflation-related increases instead of the 7% to 9% increases of the past years.

Table 1: Expected price pressures on CPI during 2021

Weighting	Item	Direction
2.6	Education & boarding	↓
8.9	Health & medical insurance	↓
15.5	Food	↑ ↔
1.8	Non-alcoholic beverages	↑
3.9	Alcoholic beverages	↑
1.9	Tobacco	↑
3.8	Clothing & footwear	↓
3.5	Actual rentals for housing	↓
13.3	Owners' equivalent rent	↓
3.2	Water & other services	↑
3.8	Electricity & other fuels	↑
4.4	Household contents	↔
5.6	New vehicles	↔↑
4.6	Fuel	↑
2.6	Communication	↔↓
5.2	Recreation & Culture	↔
3.1	Restaurants & hotels	↔
1.3	Other services (Funeral)	↔
Overall CPI		↑