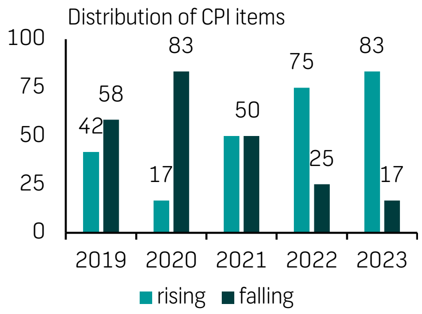
Economics weekly

25 August 2023

Slower inflation: you have seen the headlines but what does it mean for you

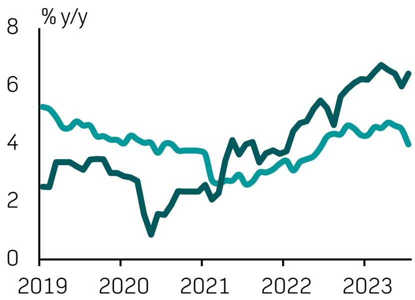
Figure 1: Inflation is broader



Source: Stats SA, FNB Economics

After nearly two years of running above 5%, headline consumer inflation fell to 4.7% in July. While this indicates that the rate at which prices are rising compared to last year is slowing, monthly pressures persist and inflation is broader, with more items rising relative to last year. In July, monthly inflation amounted to 0.9%, which reflected a 9.6% average lift in utilities that contributed 0.7ppt. Furthermore, another bout of monthly inflation is expected in September when the current under-recovery in petrol (over R1.50) and diesel (over R2.70) will feature in the data, and now that we can no longer rely on the positive base effects which drove inflation down in the past couple of months, we should see inflation lifting. An undervalued exchange rate and a still-elevated cost of doing business in South Africa usher us into a period when the sustainability of slower inflation will be tested. This will also provide clues on the efficacy of the transmission of monetary policy since the hiking cycle started at the end of 2021. Nevertheless, it has been a challenging two years, so we opt to delve deeper into the data and provide an analysis of the shifts that may have occurred on your shopping list over the past few months.

Figure 2: Services vs core goods



Source: Stats SA, FNB Economics

Services inflation only lifted to a touch above the 4.5% target midpoint earlier in the year, and fell to 4.0% in July, reflecting mild housing inflation, communication deflation, as well as easing public transport and restaurants and hotels inflation after the sharp passthrough last year. Meanwhile, core goods inflation[1] has been sticky above 6%, reflecting elevated personal care product inflation, as well as rising vehicles and alcoholic beverages and tobacco inflation. In general, higher goods inflation has highlighted the impact of supply-side pressures, including load-shedding and a weak rand, amid soft demand. This suggests that the anticipated rotation in inflation dynamics from goods to services has been muted, not only indicating the impact of shifts in consumer preference towards home ownership, but also that tighter monetary policy has dampened discretionary spending and the passthrough of higher input costs.

Nevertheless, certain goods continue to post painstakingly elevated inflation – average personal product and food prices are 12.2% and 9.9% higher than last year, respectively.

[1] *Excluding food and non-alcoholic beverages, fuel, and electricity.*

Economists

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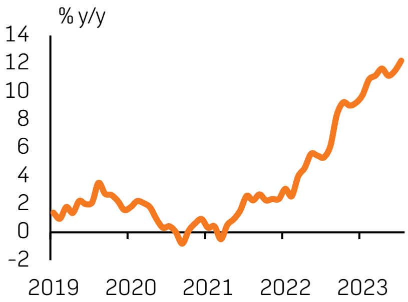
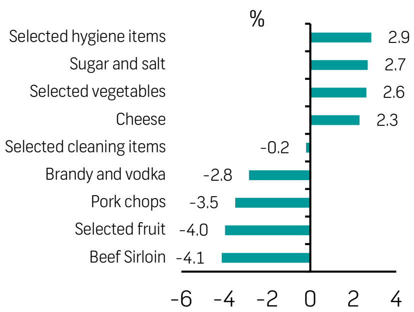
Figure 3: Personal care products



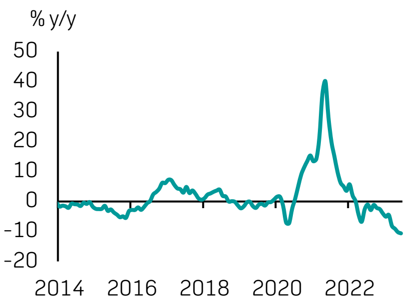
Source: Stats SA, FNB Economics

Figure 4: Average price changes over the past six months



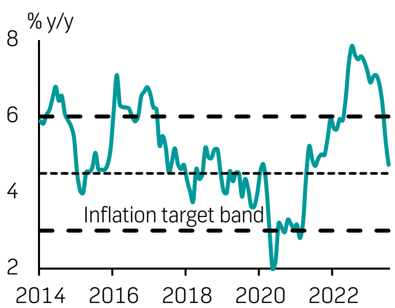
Source: Stats SA, FNB Economics

Figure 5: SARB leading indicator



Source: SARB, FNB Economics

Figure 6: CPI



Source: Stats SA, FNB Economics

So, we investigate changes in average prices over the past six months, focusing on the big movers. Dairy products such as cheese and yoghurt have risen by over 2% on average over the past six months, joined by vegetables and fruit such as broccoli, onions, potatoes, and cucumber. In addition, sugar, salt, and desserts such as ice cream have risen by 2.7% on average. This is while beef prices, excluding minced meat, have fallen and some cuts (sirloin) by over 4%. Pork prices, particularly chops, and most lamb cuts are also lower, but chicken and fish prices are generally higher. Prices for oranges, avocado and papaya are considerably lower, as are prices for brandy and vodka. On personal products, tissue and toilet paper prices have risen by over 3.5% on average, while shampoo and toothpaste prices lifted by over 2%. Fortunately, washing and cleaning product prices have slowed, albeit to a lesser degree, and wipes as well as make-up foundation prices have also fallen.

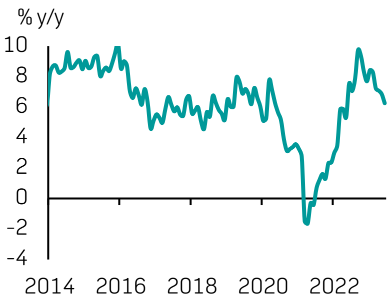
A slower lift in the general price level may not be very consoling after having experienced persistent wage compression, on average, over the four quarters to 1Q23, as well as higher debt-servicing costs. However, as inflation continues to slow, it should provide some relief. In the meantime, several items already reflect falling prices and the ramp up in electricity self-generation capacity should alleviate load-shedding intensity – gradually softening the cost of doing business, lowering the risk associated with SA assets and the adverse impact on the rand. Overtime, these are some of the key features of a sustainably lower inflation environment and less pressure on your budget.

Week in review

The composite **leading business cycle indicator** declined slightly by 0.1% m/m in June after declining by 1.7% in May. Three out of the nine constituent variables declined, outweighing the increases in other variables. The decline in the US dollar-denominated export commodity price index and the narrowing of the interest rate spread contributed the most to the marginal fall in the indicator. The leading indicator contracted by 10.6% compared to a year earlier, marking fifteen consecutive months of annual decline. The continued weakness in the leading indicator corroborates our assessment of a high likelihood of subdued (or recessionary) near-term economic growth outcomes. Our GDP growth forecast is 0.2% for this year, reflecting a significant moderation from the post-pandemic growth rebound of 4.7% in 2021 and 1.9% in 2022.

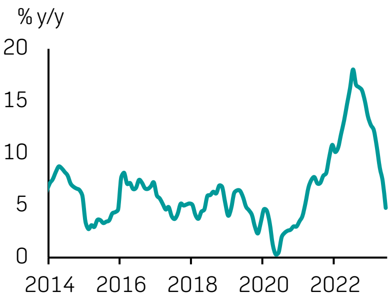
Headline inflation fell to 4.7% y/y in July, from 5.4% in June, once again reflecting continued positive base effects. Monthly inflation was 0.9%, driven by the lift in utility costs which include a 14.2% increase in electricity tariffs and a 4.7% lift in water and other utilities. Core inflation was 4.7% y/y, down from 5.0% last month, while fuel prices fell by 0.7% m/m and by 16.8% compared to last year. Food and NAB inflation was 9.9% y/y, down from 11.0% previously, and monthly price pressures were softer at 0.2%. We predict headline inflation of 4.8% y/y in August, with mild monthly inflation of 0.3% – highlighting the waning of base effects. We anticipate that headline inflation will average 5.9% this year, slowing to 4.5% by 2026.

Figure 7: Private sector credit



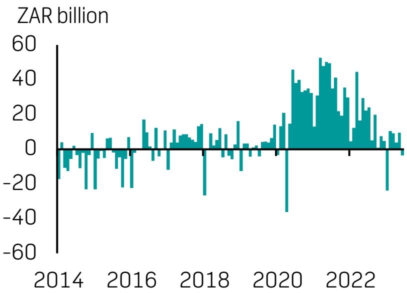
Source: SARB, FNB Economics

Figure 8: PPI



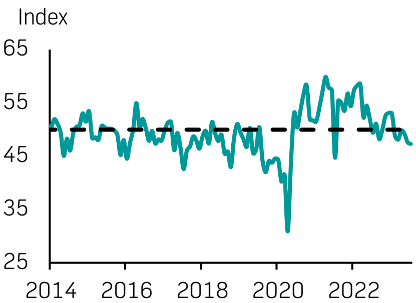
Source: Stats SA, FNB Economics

Figure 9: Trade balance



Source: SARS, FNB Economics

Figure 10: Absa PMI



Source: Absa, BER, FNB Economics

Week ahead

On Wednesday, **private sector credit extension (PSCE)** data for July will be released. In June, growth slowed to 6.3% y/y, from 6.8% in May. The slowdown reflected a moderation in both corporate and household credit. Corporate credit growth slowed to 6.1% from 6.9% previously, dragged down by slower mortgage extensions as well as investments, while support came from instalment sales and overdrafts. Credit extended to households slowed to 6.5% in June, from 6.7% in the previous month, dragged lower by unsecured credit, although credit cards uptake quickened. Asset-backed credit also slowed, on account of slower housing finance uptake. We expect PSCE to continue slowing, as the impact of interest rates hikes filters through, and lending standards tighten.

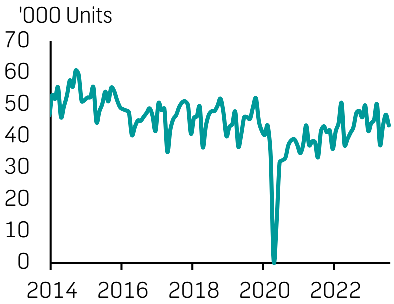
On Thursday, **producer inflation** data for July will be published. In June, producer inflation measured 4.8% y/y, down from 7.3% y/y in May and a 18.0% y/y peak in July 2022, reflecting a sustained moderation that has also recently been driven by last year's higher base. Producer prices declined by 0.3% m/m in June, following 0.6% monthly pressure in May. Intermediate producer inflation was 2.5% y/y in June, the slowest rate in almost three years. We expect the moderation in producer inflation to have continued in July, reaching 3.5% y/y, though with some monthly pressure of around 1.0%. However, the favourable base from last year is almost done, and further variations in producer inflation should broadly reflect supply-demand dynamics.

Also on Thursday, the **nominal trade balance** for July will be released. The trade balance unexpectedly switched to a R3.5 billion deficit in June, from a R9.6 billion surplus in May. This reflected a monthly decline of 8.6% in exports to R167.62 billion, while imports marginally declined by 1.6% to R171.16 billion. YTD export growth has underperformed import growth, posting a subdued 1.9% y/y, while imports have posted a solid 17.5% y/y.

On Friday, the **Absa manufacturing PMI** for August will give us further clues about manufacturing conditions. In July, the PMI highlighted a contractionary environment, and slid to 47.3 index points after registering 47.6 points in June. The business activity index shed nearly 11 index points, which likely reflected the impact of higher load-shedding compared to June, as well as supplier delivery issues. The deliveries index lifted to the highest level this year, likely highlighting the disruptions on the supply chain and activity due to the torching of trucks on the N3 during the month. New sales orders fell, amid restrictive monetary policy and lower external demand. Fortunately, the price index continued to slow and will likely contribute to slowing producer inflation going forward, bar the lift in fuel prices in August and September.

The week will close off with **NAAMSA's new vehicle sales** for August. Volume sales marked a weak start to 2H23, increasing by 1.3% y/y in July after increasing by 14.0% y/y in June. This weakening reflected a sharp 9.7% y/y decline in new passenger car sales, following average annual decline of 0.8% in 1H23. This is consistent with weaker

Figure 11: New vehicle sales



Source: Naamsa, FNB Economics

consumer fundamentals and a restrictive monetary policy environment. By contrast, growth in sales of new commercial vehicles continued into 2H23, although at a moderate pace of 29.6% y/y compared to 47.6% y/y in June.

Tables

The key data in review

Date	Country	Release/Event	Period	Act	Prior
22 Aug	SA	Leading business cycle indicator	Jun	108.3	108.4
23 Aug	SA	Headline CPI %m/m	Jul	0.9	0.2
	SA	Headline CPI %y/y	Jul	4.7	5.4
	SA	Core CPI %m/m	Jul	0.5	0.4
	SA	Core CPI %y/y	Jul	4.7	5.0

Data to watch out for this week

Date	Country	Release/Event	Period	Survey	Prior
30 Aug	SA	Private Sector Credit %y/y	Jul	--	6.3
31 Aug	SA	PPI %y/y	Jul	3.5	4.8
	SA	PPI %m/m	Jul	0.4	-0.3
	SA	Trade Balance Rand (Bn)	Jul	--	-3.5
1 Sep	SA	Absa Manufacturing PMI	Aug	47.0	47.3
	SA	Naamsa Vehicle Sales % y/y	Aug	--	1.3

Financial market indicators

Indicator	Level	1 W	1 M	1 Y
All Share	74,301.56	-0.1%	-3.2%	6.4%
USD/ZAR	18.82	-1.3%	6.0%	11.1%
EUR/ZAR	20.34	-1.8%	3.6%	20.5%
GBP/ZAR	23.71	-2.4%	4.2%	18.7%
Platinum US$/oz	938.16	4.6%	-2.4%	6.6%
Gold US$/oz	1,916.91	1.5%	-1.9%	9.5%
Brent US$/oz	83.36	-0.9%	0.7%	-17.6%
SA 10 year bond yield	10.20	-1.8%	-0.6%	-0.9%

FNB SA Economic Forecast

Economic Indicator	2021	2022	2023f	2024f	2025f
Real GDP %y/y	4.7	1.9	0.2	1.0	1.8
Household consumption expenditure % y/y	5.8	2.5	1.2	1.1	1.1
Gross fixed capital formation % y/y	0.6	4.8	4.2	3.1	4.2
CPI (average) %y/y*	4.5	6.9	5.9	5.2	4.8
CPI (year end) % y/y*	5.9	7.2	5.2	4.8	4.8
Repo rate (year end) %p.a.	3.75	7.00	8.25	7.50	7.00
Prime (year end) %p.a.	7.25	10.50	11.75	11.00	10.50
USDZAR (average)	14.80	16.40	18.50	18.00	17.50

** Preliminary*

Source: FNB