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in the moment

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Headline inflation softened to 5.1% y/y in December 2023

Highlights

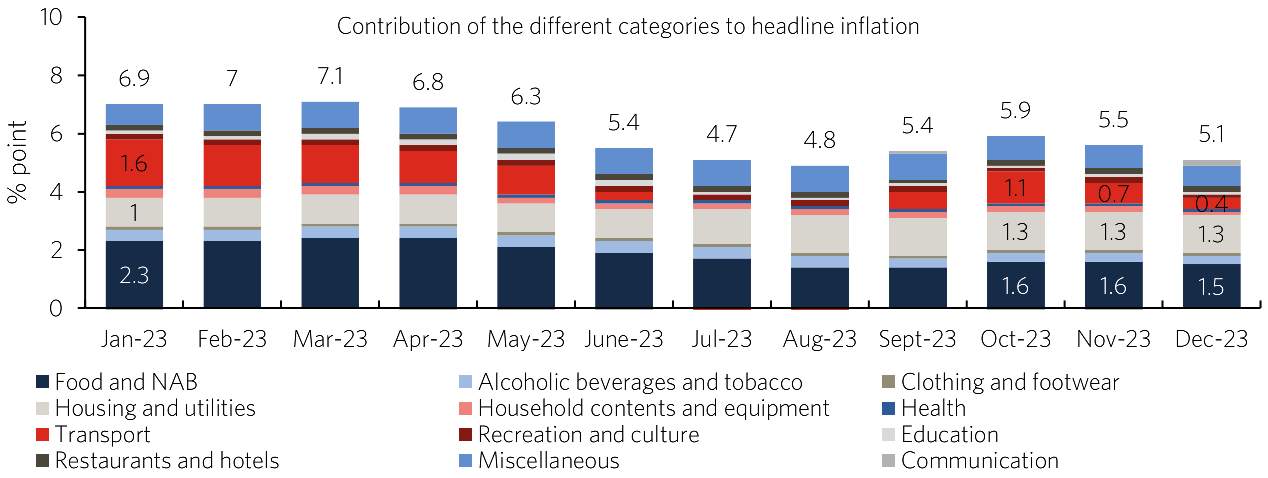
- According to Statistics South Africa (Stats SA), headline inflation (CPI) decelerated to 5.1% year-on-year (y/y) in December 2023 from 5.5% y/y in November. The annual rate was 5.9% for 2023, which is in line with our expectations.
- Core inflation (headline inflation excluding food and non-alcoholic beverages (NAB), fuel and energy) remained unchanged at 4.5% in December, resulting in an annual rate of 4.8% for 2023.
- The deceleration in December's headline inflation was largely attributed to falling fuel prices and the decrease in food and NAB inflation.
- Rental inflation edged up in December but remained subdued which signals weak demand-pull inflation.
- Transport inflation eased to 2.6% y/y in December from 4.3% y/y in November on the back of lower fuel prices. Further fuel price cuts in January will provide additional reprieve for the January inflation figure. The Central Energy Fund's (CEF) estimated under-recovery points to marginal fuel price increases of just below R0.40 c/l in February.
- The average price of Brent crude oil is falling despite the conflict in the Middle East and voluntary oil supply cuts implemented by OPEC + (Organization of the Petroleum Exporting Countries Plus). The United States (US) Energy Information Administration (EIA) forecasts the average price of Brent crude oil in 2024 at US$82/bbl. Rising geopolitical tension in the Middle East introduces a risk of oil supply disruptions which could place upward pressure on oil prices.
- Food inflation softened to 8.5% y/y in December (9% y/y in November) led by lower vegetable inflation. According to the SA Weather Service (SAWS), EL Niño has reached a "strong state" but agricultural experts maintain that the impact on food inflation will be minimal primarily due to good soil moisture.
- The Bureau for Economic Research (BER) published higher inflation expectations in its 2023 fourth quarter survey. The main cause of the upward revisions was labour unions. The SA Reserve Bank (SARB) will likely do more signalling to price setters (trade unions and businesses) to suppress cost-push pressures.
- The softer inflation rate in December, contained core inflation, falling international oil prices, the containment of the Avian flu outbreak and the expectation of a muted impact from El Niño suggest that inflation is likely to continue on a decelerating path through 2024. However, the SARB remains concerned about inflation persistence, lingering inflation risks and elevated inflation expectations. Consequently, we expect the Monetary Policy Committee (MPC) to keep the repo rate constant at 8.25% at the January 2024 meeting. In our view, the SARB needs to see a sustainable decrease in inflation first before considering interest rate cuts. We forecast the first interest rate cut to be implemented in the second quarter of 2024, at the earliest.

Transport and food inflation drive down headline inflation

Stats SA reported headline inflation at 5.1% y/y for December 2023, lower than the 5.5% y/y recorded in November. In line with our expectations, headline inflation averaged 5.9% in 2023, markedly lower than the 6.9% recorded in 2022. Although the annual outcome was slightly above the SARB's forecast of 5.8% communicated in the November interest rate setting meeting, the average annual inflation settled within the inflation target range of 3% to 6%. The sharp deceleration in inflation over 2023 (from 6.9% y/y in January to 5.1% y/y in December) is attributable to lower transport inflation and a decrease in food and NAB inflation as seen in chart 1.

The deceleration in the December headline inflation can be largely attributed to falling fuel prices. The lower-than-expected food and NAB inflation is likely the reason for the positive surprise against the Reuters median consensus of 5.2% y/y.

Chart 1: Food and transport inflation pressures dropped meaningfully throughout 2023

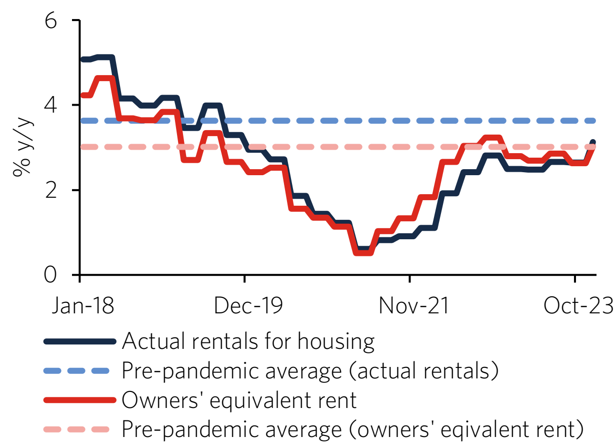


Source: Global Insight, Stats SA, Momentum Investments

Core inflation was unchanged at 4.5% y/y in December, positively surprising the Reuters median expectation for a slight uptick to 4.6% y/y. This resulted in an average core inflation rate of 4.8% in 2023, in line with the SARB's forecast and higher than 4.3% in 2022. Nevertheless, core inflation is well contained thanks to the deceleration in public transport, lower-than-anticipated labour costs and limited rental inflation.

December was a high survey month with an additional 21% of the basket surveyed, aside from the typical monthly survey. The additional surveyed items include rental costs, domestic workers' wages, car insurance, as well as taxi, train and local bus fares.

Chart 2: Rental inflation remained subdued



Source: Global Insight, Stats SA, Momentum Investments
Data until December 2023

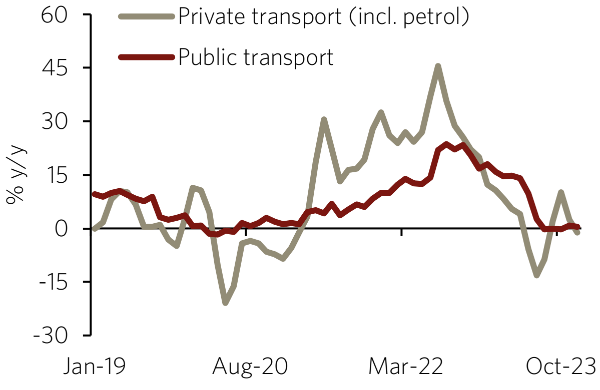
Following the unexpected decrease in rental inflation to 2.6% y/y in the September survey, owners' equivalent rent (the single-largest component of the CPI basket, accounting for 12.99% of the basket) increased by 3% y/y in December 2023. This is the same level as the pre-pandemic (2019) average (see chart 2) which suggests some recovery in the residential property market. Actual rentals for housing increased by 3.1% y/y in December from 2.6% y/y in the September survey but remained below the pre-pandemic average of 3.6%. Owners' equivalent rent and actual rental inflation were still below their respective long-term averages.

According to PayProp, positive rental growth was registered for eight consecutive quarters in the third quarter of 2023 but there is a lot of uncertainty for the rental market in 2024. On the one hand, the expected interest rate cuts may motivate first-time buyers to purchase property which would reduce rental demand. On the other hand, lower inflation rates could reduce financial strain on consumers which could be a motivation for higher rental prices.

Private transport is back in deflation territory

Transport inflation eased for the second consecutive month to 2.6% y/y in December from 4.3% y/y in November on the back of lower fuel prices. The CEF announced a R0.65 c/l reduction in the price of both grades of petrol and a larger decrease of R2.35/l for diesel (0.05%) for December. Further downside pressure on transport inflation is expected in January given the R0.76 c/l decrease in the price of petrol (95) and R1.18/l drop for diesel (0.05%). The under-recovery estimated on 22 January 2024 suggests minor fuel price hikes of around R0.36 c/l for both grades of petrol and R0.39 c/l for diesel (0.05%) in February.

Chart 3: Transport inflation lower relative to a year ago



Source: Global Insight, Stats SA, Momentum Investments
Data until December 2023

Private transport inflation slowed to negative 1.2% y/y in December 2023 (2.4% y/y in November) and public transport inflation was 0.4% y/y from 0.8% in November. Both private and public transport inflation has decelerated significantly from the peak reached in the third quarter of 2022 (see chart 3) relieving some pressure on consumer finances.

The average price of Brent crude oil has been on a downward trend since the recent peak of US$93.7/bbl recorded in September 2023. According to the EIA, Brent crude oil averaged US$77.6/bbl in December, supporting lower domestic fuel prices. The price of Brent crude oil is dropping despite voluntary oil supply cuts implemented by OPEC + countries and the conflict in the Middle East. This is because OPEC + oil production cuts were partly supplemented by higher oil production among non-OPEC countries in 2023 while the Gaza-Israel war has not disrupted the oil supply yet. The recent attacks in the Red Sea have not affected oil prices because oil is being rerouted around the Cape of Good Hope. While the alternative shipping route ensures continuous oil trade, the International Energy Agency (IEA) notes that rerouting increases voyages by up to two weeks which adds pressure on global supply chains and increases shipping costs which could be inflationary.

In the Short-Term Energy Outlook for January 2024, the EIA indicated that it expects international oil prices to average US$82/bbl in 2024 (similar to the 2023 average) because the global supply and demand of petroleum liquids are expected to be relatively balanced. Upward price pressures are expected to stem from unplanned supply disruptions such as rising geopolitical tensions.

Apart from falling international oil prices, the rand has contributed to lower domestic fuel prices but to a lesser extent. The rand was slightly stronger in December at an average of R18.30/US$ compared to R18.86/US$ in November on the back of a softer US dollar. The anticipated marginal increase in domestic fuel prices in February corresponds with the slightly weaker rand in the first two weeks of 2024 (R18.74/US$). We expect the upcoming 2024 SA general elections to keep the rand volatile as political uncertainty builds up.

Food inflation expected to moderate in 2024

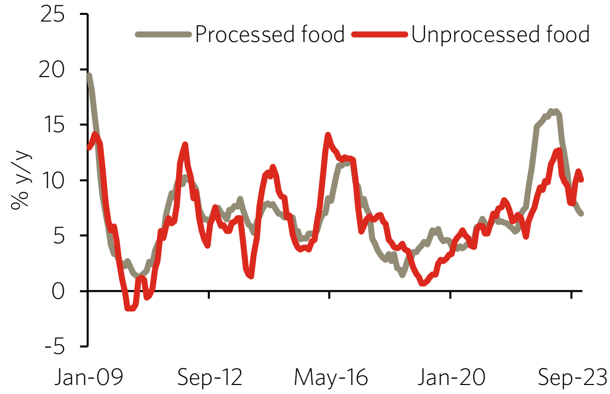
Food and NAB inflation softened to 8.5% y/y in December from 9% y/y in November. This follows three consecutive months of accelerating food and NAB inflation. The Avian flu outbreak was partly the reason for renewed upside price pressures in this category, but the outbreak is reported to be under control and the ramp up in egg imports has alleviated egg price pressures. Egg inflation dropped to 38% y/y in December from 39.9% y/y in November, but poultry products are still experiencing upward price pressure.

Local food prices increased by 8.5% y/y in December, lower than 9% y/y in November. The decrease in food inflation was largely due to vegetables (17.5% y/y from 23.5% y/y) as well as bread and cereals (7.5% y/y from 8.5% y/y). Agrikonsult states that vegetable prices were higher in 2023 due to loadshedding and its negative impact on irrigation. Given the more positive outlook on loadshedding in 2024, vegetable inflation is expected to moderate.

As seen in chart 4, upward food price pressure is experienced in unprocessed food (e.g. fruits, vegetables and meat). Less severe loadshedding may alleviate some of this pressure but the El Niño season poses an upside risk to unprocessed foods because it impacts mostly agricultural products.

According to the *Daily Maverick*, SAWS noted that "El Niño had now reached a strong state" with below-normal rainfall expected between January and May apart from the central and eastern coastal areas where above-normal rainfall can be expected". Agricultural experts maintain that good soil conditions will likely reduce the impact of El Niño. According to Agrikonsult, February is the high-risk month that has the potential to change the agriculture outlook. Dry weather conditions are expected to wane by winter (June to August) and move to neutral conditions (between El Niño and La Niña).

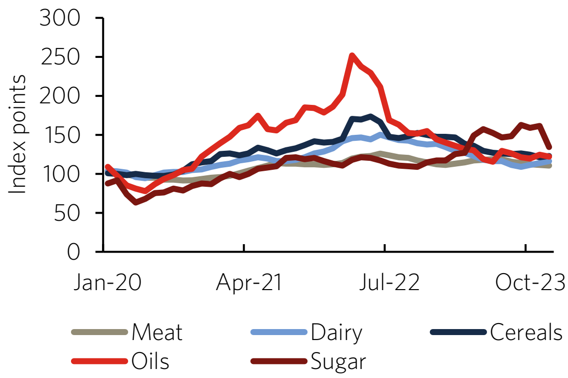
Chart 4: Unprocessed foods inflation at 10% y/y in December 2023



Source: Global Insight, Stats SA, Momentum Investments
Data until December 2023

Overall, Agrikonsult notes that the agriculture sector is in good condition and food inflation is expected to trend lower in 2024. The food categories that are expected to contribute to the downward trend are vegetables, fruits, oils, dairy and eggs. Meat and fish could result in upward price pressures and grain products are expected to trend sideways.

Chart 5: Sharp drop in the FAO's sugar price index



Source: Global Insight, Stats SA, Momentum Investments
Data until December 2023

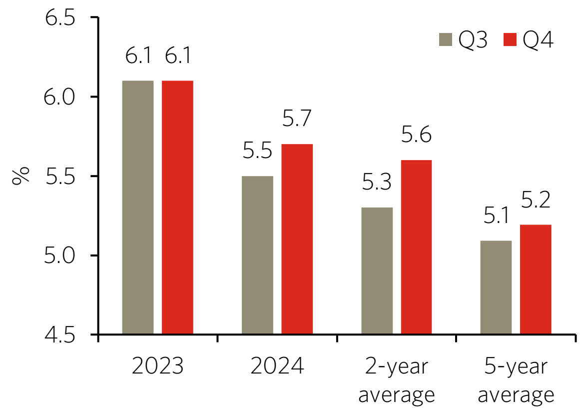
The United Nations (UN) Food and Agriculture Organisation (FAO) nominal Food Price Index decreased by 1.5% month-on-month (m/m) to 118.5 points in December 2023. The most notable change was the 16.6% m/m decrease in the sugar price index to 134.6 points, the sharpest decrease since March 2020. The FAO attributes the drop in sugar prices to higher production in Brazil supported by conducive weather conditions.

Broad-based deterioration in inflation expectations

As anticipated, average inflation expectations for all time horizons apart from 2023 edged higher in the BER's fourth quarter survey results (see chart 6) following the broad-based decrease in the third quarter. The upward revisions were likely influenced by accelerating inflation in the months preceding the survey. Two-year average inflation expectations increased the most from 5.3% toward the upper limit of the inflation target range at 5.6%. This, together with the uptick in longer-dated inflation expectations (five-year average), will likely be a concern for the SARB.

Disaggregating the inflation expectations results shows that trade unions were largely responsible for the increase in expectations across the different forecast periods which could potentially be an added layer of concern for the SARB given the price-setting role that trade unions play in the market. Additionally, although businesses kept their five-year average forecast unchanged at 5.5%, this group has the highest expectations among the three social groups. SARB is likely to keep interest rates elevated to send a signal to price setters that the MPC remains committed to bringing inflation down.

Chart 6: Inflation expectations edged higher in 2023 Q4



Source: Global Insight, BER, Momentum Investments

The SARB is expected to keep the repo rate unchanged

Annual inflation for 2023 settling below the 2022 average and within the SARB's inflation target band, is an important milestone for the MPC in the fight against inflation. However, inflation is still elevated which signals that the battle is not yet over. The SARB expects the inflation rate to fall closer to the mid-point of the target range (their preferred position) in the fourth quarter of 2024 and average 5% in 2024 before stabilising at 4.5% in 2025. We project an average inflation rate of 5.3% in 2024 (higher than the SARB) and 4.5% in 2025.

The softer inflation rate in December, contained core inflation, falling international oil prices despite conflict in the Middle East, the containment of the Avian flu outbreak and the expectation of a muted impact from El Niño suggest that inflation is likely to continue on its deceleratiing path through 2024. However, risks to the inflation outlook remain, including rising geopolitical tensions, medical costs, currency fluctuations, logistics constraints, administered prices, weather conditions and government finances ahead of elections. We expect the SARB to keep the repo rate unchanged at 8.25% for the fourth consecutive time at the January 2024 meeting. The MPC is likely to maintain a hawkish tone in light of the lingering upside risks to inflation, elevated inflation expectations, which the SARB aims to anchor around the mid-point of the target range, and concerns of inflation persistence highlighted at the 2024 World Economic Forum in Davos.

The SARB needs to see a sustainable decline in inflation before starting the interest rate cutting cycle. In our view, the SARB will likely maintain a restrictive policy and implement the first rate cut in the second quarter of 2024, at the earliest.