



Medical and fuel inflation drove inflation higher in February

Highlights

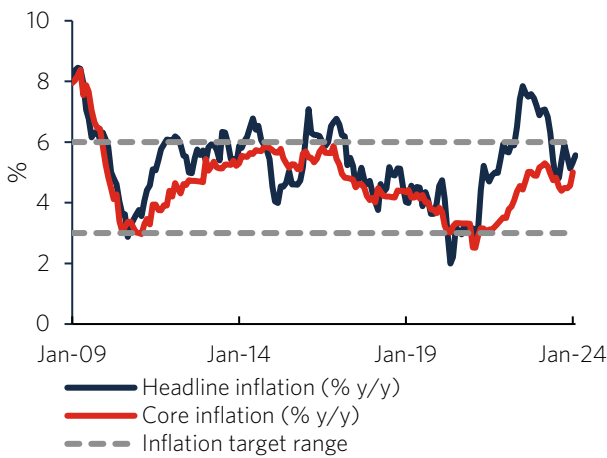
- According to Statistics South Africa (Stats SA), the consumer price index (CPI or headline inflation) rose to 5.6% year-on-year (y/y) in February 2024 from 5.3% y/y in January. Core inflation accelerated to 5% y/y from 4.6% y/y over the same period.
- Higher medical insurance costs were the main reason behind the lift in core inflation and subsequently headline inflation. Higher fuel prices also contributed to the uptick in headline inflation.
- Medical insurance inflation spiked from 6.9% y/y in January to 12.9% y/y in February. This reflects the substantial membership contribution hikes implemented by medical schemes in 2024 and the inclusion of all the tariff hikes in the February survey (base effects) as opposed to the typical bi-annual survey for medical aid rates.
- The fuel price increases implemented in February were the main reason for higher transport inflation in February (5.4% y/y from 4.6% y/y in January). The larger fuel increases (above R1/l) in March point to further upside pressure on transport inflation in March. Early data from the Central Energy Fund (CEF) indicate a slight increase (R0.14/l) in the price of petrol (95, inland) but diesel (0.05%) users can expect a slight reprieve of R0.32/l in April.
- The ongoing tensions in the Red Sea and the extension of voluntary production cuts by the Organisation of the Petroleum Exporting Countries Plus (OPEC+) are keeping international oil markets tight. The United States (US) Energy Information Agency (EIA) forecasts oil prices to remain elevated at an average of US\$88/bbl in the second quarter of 2024, which introduces upside price pressures domestically, especially if the rand remains weak.
- Further upside price pressures stem from intensifying drier weather conditions in some parts of SA during February and March 2024, an important period for agriculture according to the Agricultural Business Chamber of SA (Agbiz). The Crop Estimates Committee (CEC) has revised the expected commercial maize crop lower by 12.6% to 14.4 million tonnes for 2024. However, this remains sufficient to meet domestic demand. Other parts of Southern Africa are reported to be experiencing harsher and drier weather conditions than SA.
- The 2024 starting point of the United Nations (UN) Food and Agriculture Organisation's (FAO) Food Price Index (FPI) was much lower than 2023 and 2022 and decreased further by 0.7% month-on-month (m/m) in February.
- The Bureau for Economic Research (BER) published lower inflation expectations for the first quarter of 2024 survey results at 5.4% for 2024 and 5.3% for 2025. The driver for lower expectations in both years were the price setters (businesses and trade unions) of the economy.
- We maintain our view that the SA Reserve Bank (SARB) will likely keep interest rates constant at 8.25% at the March interest rate setting meeting.

- We acknowledge the increased risks to our longstanding view that the SARB will begin the rate cutting cycle in the second quarter of 2024, at the earliest. These risks include the possibility of higher food inflation due to intensifying El Niño conditions, volatile and elevated inflation outcomes, still elevated inflation expectations and caution displayed by global central banks by keeping interest rates higher than the market had initially anticipated. We see the first move lower in SA interest rates increasingly more likely to commence in the third quarter of 2024.

Medical insurance inflation almost doubled to 12.9% y/y in February

Headline inflation, reported by Stats SA, rose to 5.6% y/y in February from 5.3% y/y in January. This marks the second consecutive increase and the CPI print was slightly higher than the Reuters median consensus of 5.5% y/y. Encouragingly, CPI remained within the inflation target range of between 3% and 6% but is hovering around the upper limit of the target (see chart 1). The culprits for higher headline inflation in February were fuel and medical insurance costs.

Chart 1: Medical aid tariffs drive up core inflation



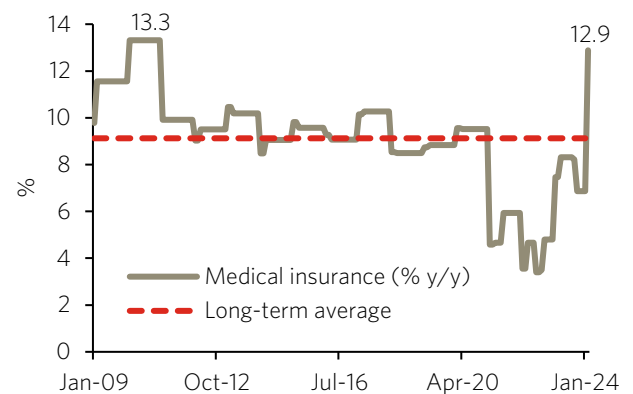
Source: Global Insight, Stats SA, Momentum Investments
Data until February 2024

Core inflation accelerated from 4.6% y/y in January to 5% y/y in February, the highest-level since June 2023. Similar to headline inflation, this was the second consecutive increase. On a month-on-month basis, core inflation rose by 1.2% largely driven by higher medical insurance inflation.

Medical insurance (accounts for 7.1% of headline inflation and 13.9% of the core basket) rose to 12.9% y/y in February from 6.9% y/y in January (see chart 2). The sharp jump was on the back of high increases in membership contributions from medical schemes (see

table 1). The timing of the premium increases partly contributes to the sharp increase in medical insurance inflation. According to Stats SA, all the medical schemes in their sample effected premium increases by the time of the survey which means all the price changes have been accounted for in the February survey. As a result, there won't be a second survey for medical aid rates in April.

Chart 2: Medical insurance inflation surges to the second highest historical level in February 2024



Source: Global Insight, Stats SA, Momentum Investments
Data until February 2024

Table 1: Medical schemes implemented sharp contribution increases in 2024 (%)

Medical scheme	2023 average increase	2024 average increase
Bestmed	8.5	9.6
Bonitas	5.9	6.9
Discovery Health	8.2	7.5
Fedhealth	8.8	10.8
Gems	5.0	9.4
Medihelp	7.5	16.0
Medshield	6.7	5.0
Momentum Health	6.4	9.6
Average increase	7.1	9.4

Source: ABSA, Momentum Investments

According to government, medical scheme fees should be reduced once the National Health Insurance (NHI) comes into effect. This is because NHI intends to offer comprehensive cover and medical schemes will no longer cover benefits that are covered by NHI. This introduces potential downside pressure on services inflation and consequently headline inflation in future if the NHI is executed accordingly. The NHI bill has been approved by parliament and needs to be signed by President Cyril Ramaphosa but there is no clear time frame of when the president will sign the bill into law

and if it will remain in the current format. Regardless, once signed, it will likely take years before NHI is fully implemented which means the status quo of medical aids will be maintained until then.

Goods inflation decelerated to 6.2% y/y in February from 6.6% y/y in January. On the other hand, services inflation accelerated from 4% y/y in January to 4.9% in February, breaching the 4.5% mark after six consecutive months of tracking below the mid-point of the inflation target.

Higher fuel prices exerting upward pressure on transport inflation

Transport inflation lifted to 5.4% y/y (contributing 0.8 percentage point) in February from 4.6% y/y in January. Higher transport inflation was largely driven by the fuel price increases implemented during February. The price of both grades of petrol increased by R0.75/l and diesel (0.05%) increased by R0.73/l. Consequently, fuel inflation was higher at 5.4% y/y in February from 3.3% y/y in January.

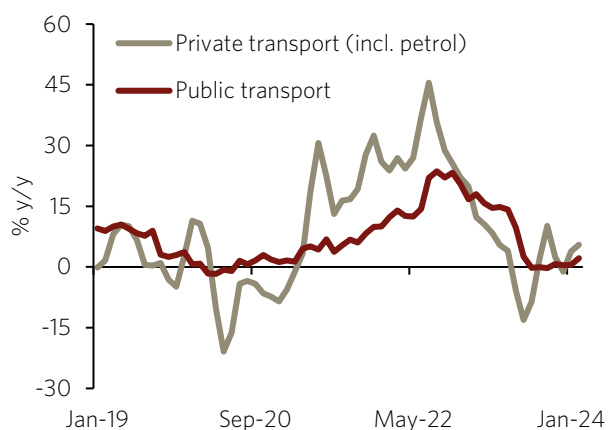
Private transport inflation went up to 5.5% y/y from 3.8% y/y in January. Public transport inflation also edged up to 2.2% y/y from 0.5% y/y over the same period after remaining largely flat for six consecutive months (see chart 3). Within public transport, passenger transport by air accelerated to 9.1% y/y in February (7.9% y/y in January).

The average inflation rate of households in expenditure deciles eight to 10 (most affected by higher fuel prices and medical insurance costs) increased to 5.5% y/y in February from 5.1% y/y in January. Households in expenditure deciles one to three are still experiencing the highest average inflation rate (6.4% y/y in February) among the different expenditure deciles but this group's inflation rate has been moderating for the past three months.

The large fuel increases of R1.21/l for both grades of petrol and R1.06/l for diesel in March signal further upside pressure on transport inflation in March and an increased financial burden for households in the higher expenditure deciles.

Early data from the CEF (published on 18 March 2024) points to a slight increase of R0.14/l for petrol (95) and a decrease of R0.32/l for diesel (0.05%) in April. The increase in the price of petrol is due to higher international oil prices on the back of geopolitical tension and the extension of voluntary OPEC+ production cuts until the second quarter of 2024. The price of Brent crude oil averaged US\$83.5/bbl in February, up from US\$80.1/bbl in January and has been rangebound between US\$83/bbl and US\$86/bbl in March. The EIA notes that oil prices may remain elevated in the second quarter of 2024 at an average of US\$88/bbl (US\$4 higher than the previous forecast). Tensions in the Red Sea and the subsequent longer delivery time due to rerouting around the Cape of Good Hope are keeping the oil market tight. According to the International Energy Agency's (IEA) March Oil Market

Chart 3: Rise in transport inflation off a low base



Source: Global Insight, Stats SA, Momentum Investments
Data until February 2024

Report, “global on-land oil inventories fell for a seventh consecutive month to reach their lowest level since at least 2016” and oil on water surged to the highest level since the height of the pandemic.

Intensifying El Niño a threat on food inflation

Food and non-alcoholic beverages (NAB) inflation eased noticeably from 7.2% y/y in January to 6.1% y/y in February. Consequently, the contribution of food and NAB to headline inflation decreased to 1.1 percentage points in February (previously 1.3 percentage points). Separately, food inflation was lower at 6% y/y (previously 7% y/y) and NAB inflation decelerated to 7.5% y/y (previously 8.1% y/y).

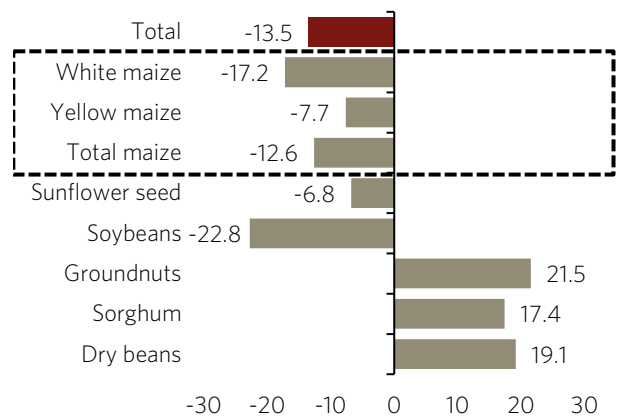
SA has, for the most part, dodged the harshest impact of the ongoing El Niño season. Moreover, the country was largely cushioned by good soil conditions from the past three consecutive seasons of La Niña.

Consequently, the prospects for summer crops were positive despite El Niño. Agrikonsult previously flagged February 2024 as a risk and this risk has materialised with parts of SA experiencing below-expected rainfall during February and extending into March. The UN’s Office for the Coordination of Humanitarian Affairs (OCHA) notes that SA may experience a decrease in crop production due to these drier conditions. According to Agbiz, February is particularly important for agriculture production because summer grains including maize, soybeans and sunflower seed are in the pollination stage.

The CEC’s first forecast for 2024 summer crops indicates a 13.5% drop in total crops compared to 2023 (see chart 4), likely incorporating risks of the drier weather conditions. The largest decrease (22.8%) is recorded for soybeans but more important to note is the expected decrease in total maize production (12.6% to 14.4 million tonnes). Yellow maize accounts for 42% of total summer crops in 2024 and production is forecasted to be 7.7% lower than the previous season. A bigger hit of 17.2% is expected for white maize, in particular, which accounts for 40% of total summer crops. This is also reflected in the increase in white maize prices (see chart 5) which suggests upward pressure on food inflation in the coming months.

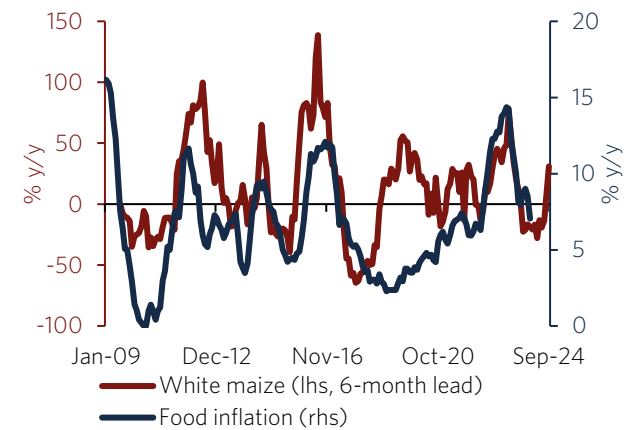
The slightly stronger rand is helping prevent a larger increase in petrol prices in April. The rand averaged R18.80/US\$ in the first two weeks of March compared to R18.93/US\$ over the same period in February.

Chart 4: Lower summer crop production expected in 2024 (%)



Source: CEC, Momentum Investments

Chart 5: Surge in white maize futures



Source: Iress, Momentum Investments

According to the OCHA, the impact of El Niño has intensified in Southern Africa with the region reported to have experienced one of the driest Februarys in over 40 years and consequently lost a lot of crops. The countries most affected or regarded as high risk during the first quarter of 2024 are Zambia, Zimbabwe, Lesotho, eSwatini as well as parts of Malawi, Mozambique, Angola, Botswana, and Madagascar. Agbiz notes that SA still has a relatively stable grain supply compared to other parts of Southern Africa. In

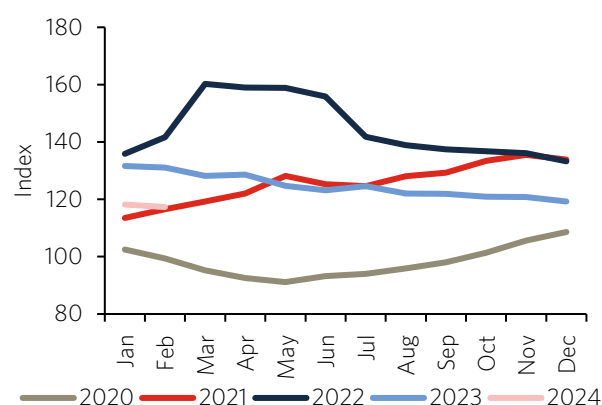
terms of maize, Agbiz indicates that if the CEC’s harvest estimate of 14.4 million tonnes materialises, SA would be able to meet domestic demand of roughly 12 million tonnes and remain a net exporter, albeit at lower levels.

OCHA notes that El Niño is forecasted to continue until April 2024 but remain milder than in 2015. In the October 2023 Monetary Policy Review, the SARB noted that a drought such as the one in 2015-16 could add up to 10 percentage points to food inflation and three percentage points to headline inflation. Given that the ongoing drought has been milder than 2015-16, the inflationary impact is not expected to be as significant. The SARB further noted that “the full impact of El Niño takes up to a year to crystallise and feed through to both domestic and global food prices”.

The UN’s FAO FPI decreased slightly to 117.3 in February 2024 (118.2 in January). This is slightly above the levels recorded in February 2021 but well below the levels recorded in 2022 and 2023 (see chart 6). The

lower FPI is due to cereals (5% m/m decrease) and oils (1.3% m/m decrease). The decrease in the cereals price index is due to softer wheat, maize, barley and sorghum prices. Contrary to Southern Africa, maize harvests are expected to be large in Argentina and Brazil, contributing to lower maize export prices.

Chart 6: FAO FPI sustainably on a downward trend



Source: UN FAO, Momentum Investments

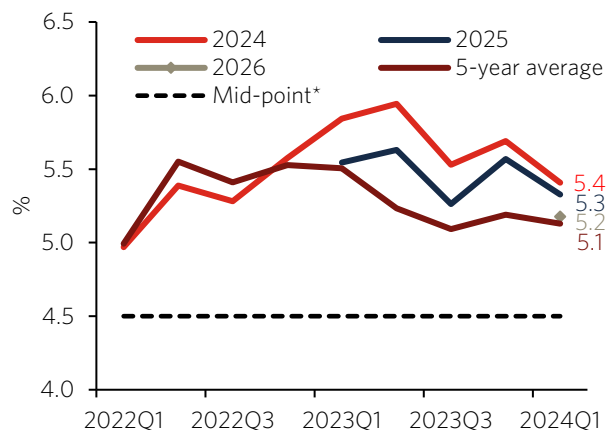
Inflation expectations retreated in the first quarter of 2024 but remain elevated

Inflation expectations, surveyed by the BER for the first quarter of 2024, were lower for 2024 and 2025 compared to the fourth quarter results in 2023. The new expectation for 2026 came in lower than 2024 and 2025 expectations (see chart 7).

The average inflation expectation for this year is 5.4%, 0.3 percentage points lower than what was expected in the fourth quarter of 2023. The downward revision was due to a 0.4 percentage point decrease in the expectations of businesses (5.8%) and trade unions (5.5%). Analysts’ inflation expectations were broadly unchanged at 5%.

The lower average inflation expectation for 2025 was again driven by the price setters (businesses and trade unions) which is encouraging especially given the recent upticks in inflation. This signals that these respondents believe that inflation will trend lower. However, 5.2% expected in 2025 is well above the SARB’s forecast of 4.6%. Analysts are expecting inflation to average 4.7% in 2025 (unchanged from the previous estimate).

Chart 7: Inflation expectations shift lower



Source: Iress, Momentum Investments

* Mid-point of the inflation target range

Average inflation in five years is expected to be slightly lower at 5.1% (previously 5.2%). Analysts lowered their estimate from 4.9% to 4.7%. Businesses also lowered their estimate from 5.5% to 5.4%. However, trade unions revised their estimate up to 5.3% (previously 5.2%).

The first quarter of 2024 inflation expectation results display a positive downward trend but expectations remain well above the mid-point of the inflation target range (see chart 7). The SARB has repeatedly indicated that they prefer inflation expectations to be anchored around the midpoint of the target range which means that while expectations are trending downward, more still needs to be done. The 2024 Macroeconomic Policy Review acknowledged that anchored inflation expectations are an important aspect of achieving the inflation target goal.

The inflation target regime is reported to have decreased the average inflation rate and inflation volatility over time. In the same breath, government notes that SA's inflation rate remains above the global average and higher than that of our trading partners because SA's inflation target range is wide. Therefore, SA could benefit from a lower inflation target range from the perspective of a lower the average inflation rate which would consequently result in inflation expectations stabilising at lower rates in the long run.

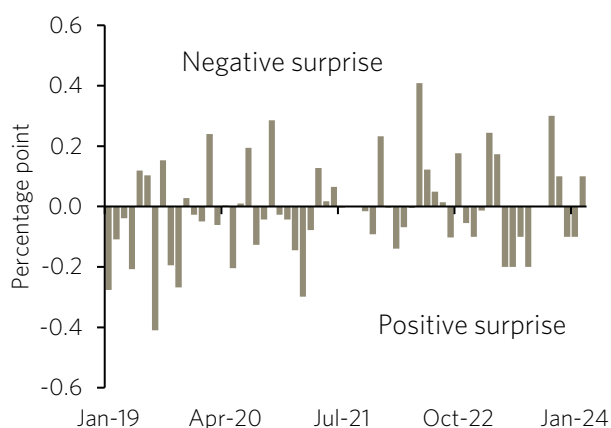
Risks skewed towards a shallower and delayed interest rate cutting cycle

One of the biggest risks to the inflation trajectory is El Niño weather conditions which were previously forecasted to be mild but has intensified during February and March 2024. The drier weather conditions are a potential risk for the food inflation outlook in particular which accounts for 15.3% of the CPI basket. In the January 2024 interest rate setting meeting, the SARB revised its food inflation forecast up to 5.7% in 2024 (5.5% previously) noting the unpredictability of food inflation.

lead the SARB to keep the repo rate elevated for longer especially considering the SARB's remarks that they need to see a discernible trend that inflation is coming down toward the midpoint of the inflation target.

A third aspect pointing toward a delayed start to the interest rate cutting cycle is still elevated inflation expectations. Keeping interest rates higher for longer-than-expected may be a strategy that is implemented to communicate the commitment to arrest inflation and guide it back toward the 4.5% mark.

Chart 8: More than half of the inflation surprises since January 2019 have been positive



Source: Bloomberg, Momentum Investments
 Data until February 2024
 Negative surprise = Inflation outcome was greater than anticipated.
 Positive surprise = Inflation outcome was smaller than anticipated

Secondly, the volatility of inflation outcomes coupled with the fact that headline inflation is hovering around the upper limit of the inflation target band may be a concern for the SARB. This is another factor which may

Lastly, major global central banks are signally toward a delayed and shallower interest rate cutting cycle. This is an important consideration from an interest rate differential perspective.

Despite a slightly higher-than-expected jump in the inflation measure in February, we maintain our view that the SARB will keep interest rates constant at 8.25% at the March interest rate-setting meeting. We acknowledge the increased risks to our longstanding view that the SARB will begin the rate cutting cycle in the second quarter of 2024, at the earliest, given recent global and local developments which point to a delayed and shallower interest rate cutting cycle. We see the first move lower in interest rates increasingly more likely to commence in the third quarter of the year on the back of still-elevated inflation expectations, lingering global inflation fears stalling global central bank action to lower interest rates and continued upside pressures to the local inflation profile.

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