EcoBulletin

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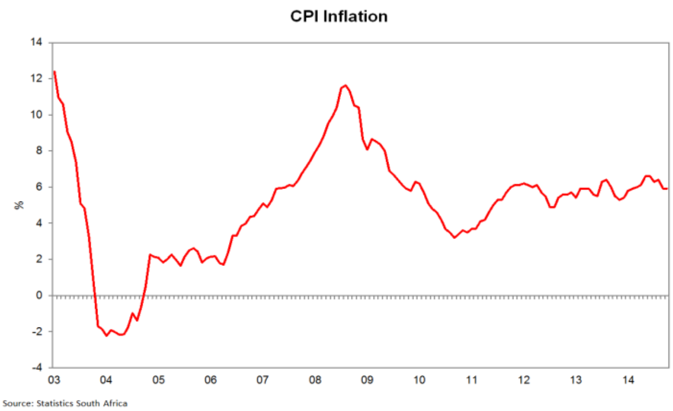
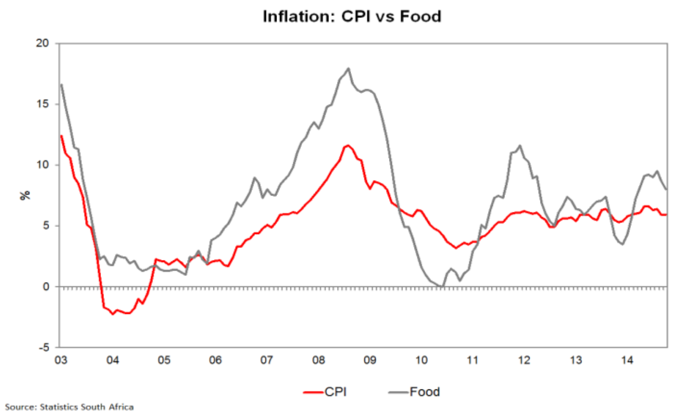
Many Disinflationary Forces Still Evident In October, Despite Unchanged CPI Inflation

Key Points

- The y-o-y CPI inflation rate remained unchanged in October, at 5.9%. This was in line with consensus forecasts.
- Superficially, the unchanged inflation number might suggest that the disinflationary pressures reflected in the steep decline in inflation in September had petered out by October. However, closer analysis reveals that many products and services still reflected further declines in October on the back of a slowdown in the rate of depreciation of the Rand over the course of the year. Included in this category were the inflation rate of food and the inflation rates of many durable goods. It is just that a few items, most notably beverages, clothing and hotels, recorded substantial increases for the month which neutralised many of the other decreases.
- Despite the unchanged outcome for inflation in October, the CPI inflation rate is expected to decrease further over the next couple of months. The most important contributor towards such a decline is likely to be the fall in fuel prices. Nonetheless, there are also likely to be further instances of declining inflation emanating from the stabilisation of the Rand over the course of the year and the relative absence of pass-through effects.
- Inflation is likely to remain within the 3% to 6% inflation target range for the foreseeable future. Given the decline in many commodity prices, especially crude oil, in recent months and the associated diminution of inflationary pressures worldwide, together with a delay in the time horizon at which interest rates globally are expected to begin rising, the Reserve Bank is unlikely to increase interest rates any time soon. Instead, it is likely to rely on inflation falling as the means through which real interest rates might be increased without raising the nominal repo rate.





Inflation Declines Ever So Marginally In October

The headline CPI inflation rate remained unchanged in October, at 5.9%, in line with consensus forecasts. In reality the inflation rate did decline, but did so only at the second decimal point, falling to 5.904%, from 5.916%. Our own forecast was for a slightly bigger decline, down to 5.8%, but the differences are neither here nor there. The figure is still leaves the inflation rate within the official 3% to 6% inflation target and there is reason to believe that this situation will remain intact over the next few months. We had expected a marginal further decrease in inflation because of the relative strength of the Rand over the course of this year and the manner in which this was likely to see inflationary pressures dissipating. In addition, commodity prices, especially of agricultural food items and crude oil, have declined significantly over the past six to nine months, thereby also are likely to contribute towards declining inflationary pressures. Evidence of such disinflation may not be apparent from the more or less unchanged CPI inflation rate, but this masks the fact that many disinflationary pressures were still in evidence. In aggregate, the inflation rate of durable goods fell for a second successive month to 3.5% in October, from 3.8% in September and a peak of 4.5% in August. The inflation rate of nondurable goods remained unchanged at 6.3%, as the impact of falling food inflation was neutralised mainly by rising petrol inflation. It was mainly in the semi-durable goods category where inflation had posted an unexpected increase, edging upwards to 5.0% in October, from 4.9% in September. The inflation rate of services, excluding owners' equivalent rent, edged downwards slightly to 6.5% in October, from 6.6% in September, whilst the inflation rate of goods fell from a peak of 7.5% in May down to 5.8% in September and now further down to 5.6% in October. Excluding food, housing and petrol, a measure of so-called "core inflation" remained unchanged in October, at 5.9%, the same level as the overall CPI inflation rate.

Inflation Of Food And Durable Goods Continues Declining

Evidence of the disinflationary impact of the absence of material depreciation in the Rand since February and the associated dissipation of inflationary pressures is provided by the outcomes for food inflation and for the inflation rate of durable goods in October. Food inflation fell quite sharply, down to 8.0% in October, from 8.7% in September and a recent peak of 9.5% in August in lagged response to the steep decline in agricultural futures prices of maize and other staple products in the second quarter. Examples of the effect of the decline in these prices is the fact that the inflation rate of bread declined to just 5.2% in October, from 5.9% in September and a recent peak of 10.5% in June. Inflation of fats and oils fell to -1.8% in October, compared with 6.2% in April and -1.1% in September. Inflation of vegetables declined to 8.9% in October, from 13.0% in September. In the case of durable goods, the most important contributor to the decline was in respect of vehicles. These have a relatively high imported component and are therefore intimately affected by movements in the Rand's exchange rate. It is therefore relevant to note that the dissipation of inflationary pressures due to Rand stabilisation is manifested in the decline in the inflation rate for vehicles for the second successive month to 5.7% in October, from 5.9% in September and 6.4% in August. Similarly, the inflation rate of furniture declined from 0.7% in July and -1.3% in September, to -2.7% in October. Associated with this, the inflation rate of household appliances, which peaked at 4.0% in June, declined to 2.9% in September and down further to 2.4% in October. There were also some other encouraging sources of disinflation in October, including building maintenance (down to 5.0%, from 5.6% in September), communications (down from -1.3% in September, to -1.9% in October), recreational equipment (down to 0.4% from 0.7%), restaurants (down to 8.9% from 9.1%) and personal care (down to 5.4% from 6.2%).

Disinflationary Pressures Neutralised By Increases In Inflation Of Clothing, Beverage And Hotels

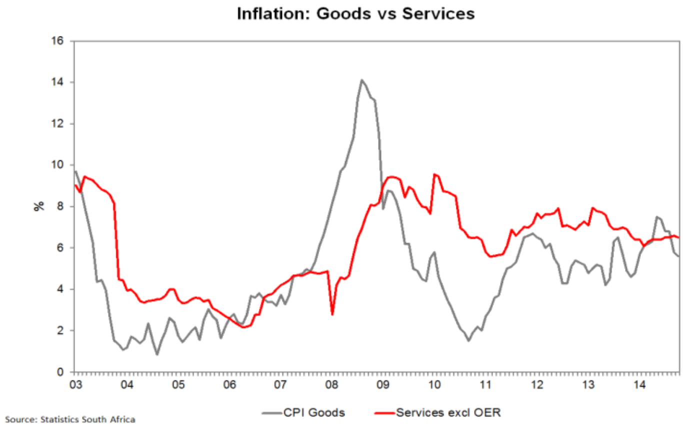
In the face of such disinflationary pressures, there were unfortunately some unexpected increases in inflation of some goods and services which neutralised the effects of the decline in the inflation rates of the goods and services outlined above. One of these, viz. the increase in petrol inflation, was indeed anticipated. Even though the price of petrol was reduced by -5 cl in October, it had been reduced by a much bigger -19 cl in October 2013. As a result, the y-o-y inflation rate of petrol rose moderately to 2.4% in October, from 1.1% in September. Given the 5.68% weighting of petrol within the overall CPI inflation rate, this exerted upward pressure on the headline CPI inflation rate, of 0.08%, largely neutralising the countervailing downward pressure on CPI inflation, of -0.1% in respect of the fall in food inflation. Nonetheless what was surprising was the sudden 1.0% rise in the inflation rate of alcoholic beverages, to 6.3% in October, from 5.3% in September and the corresponding increase in the inflation rate of clothing, to 5.9% in October, from 5.5% in September. These two outcomes seemed to counter the other disinflationary trends in respect of many other products. In addition, the inflation rate of hotels shot up to 9.3% in October, from 8.1% in September and 7.5% in August. Examination of the monthly figures for hotel inflation suggests that such inflation reacts quite speedily to currency depreciation, especially in the Rand/Dollar exchange rate. Bearing in mind that the Rand depreciated suddenly during the course of October, it is possible that the hotel industry immediately try to compensate by raising tariffs on the assumption that the fall in the Rand will leave hotel tariffs unchanged in foreign currency terms even though they might have been increased in Rand terms.

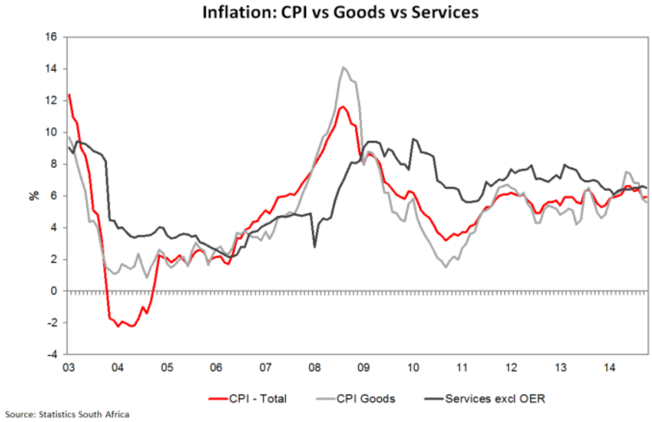
Further Declines In Inflation On The Cards

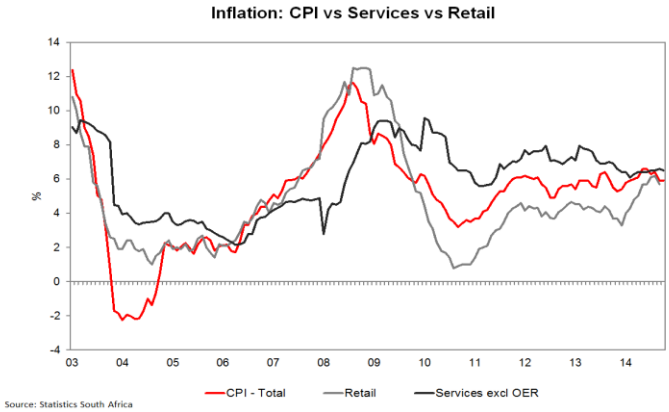
As much as one might be slightly disappointed with the overall unchanged outcome for the October CPI inflation rate, the fact is that there are further disinflationary pressures in the pipeline likely to emerge over the next few months. Most important amongst these is petrol. Unlike the situation in October where statistical factors prevented the petrol inflation rate from declining, this situation is unlikely to be repeated in November and December. In particular, an expected -60cl-odd reduction in the petrol price early next month is likely to drag petrol inflation down sharply by the time the December inflation figures are released in mid-January. As a result, the CPI inflation rate, other things equal, should be down to at least 5.6% for December. On top of this, it is conceivable that food inflation might decrease further in lagged response to earlier declines in prices of maize and other staples. Furthermore, it is also possible that one will witness further declines in the inflation rates of import-intensive durable goods in response to the fact that the exchange rate of the Rand has not depreciated in nominal terms on a trade-weighted basis since February. Obviously, beyond December, this situation could be reversed in the event that commodity prices, especially those of crude oil, begin to recover. However, as of now there is no evidence of that situation emerging yet.

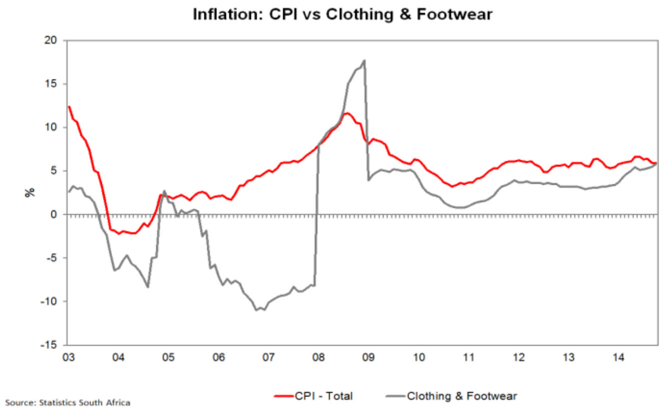
Interest Rates Likely To Be Left Unchanged

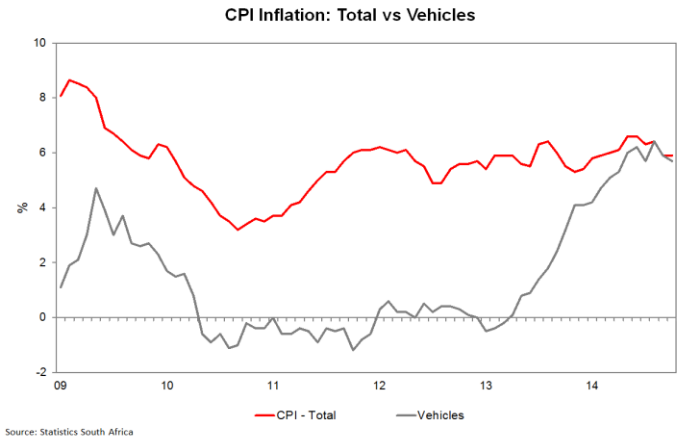
Even though the unchanged CPI inflation rate in October might have proved slightly disappointing for some, the fact is that evidence for disinflation was still in abundance. In addition, the continuing decline in commodity prices of recent months and the countervailing resilience of the Rand's exchange rate should see the inflation rate remaining well within the inflation target over the next few months. Furthermore, internationally, signs of weakening global economic activity and rising fears of deflationary pressures, have resulted in expectations of any concerted rise in interest rates around the world been pushed out well into 2015. Under such circumstances, it is highly likely that the Reserve Bank will opt to leave interest rates unchanged when it announces its decision tomorrow. Although the Bank has professed to be keen to "normalise" interest rates, i.e. raise them to levels above inflation as a means of encouraging savings, it is likely that the Bank will opt to bring about such a situation by keeping the repo rate unchanged, but seeing real interest rates rising through a fall in inflation rather than a rise in interest rates.

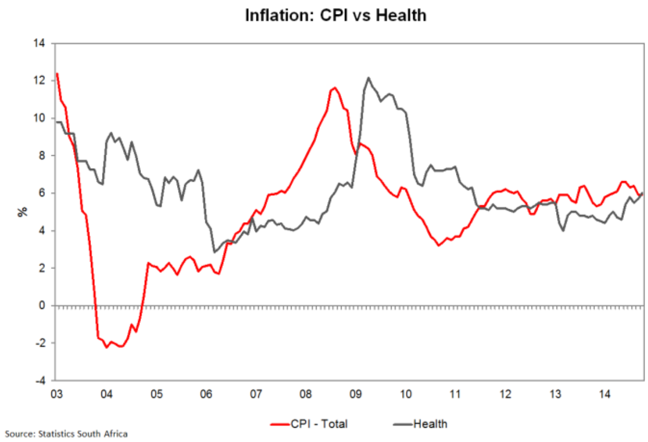

Inflation: Goods vs Services
16
14
12
10
8
6
4
2
0
%
03 04 05 06 07 08 09 10 11 12 13 14
CPI Goods
Services excl OER
Source: Statistics South Africa

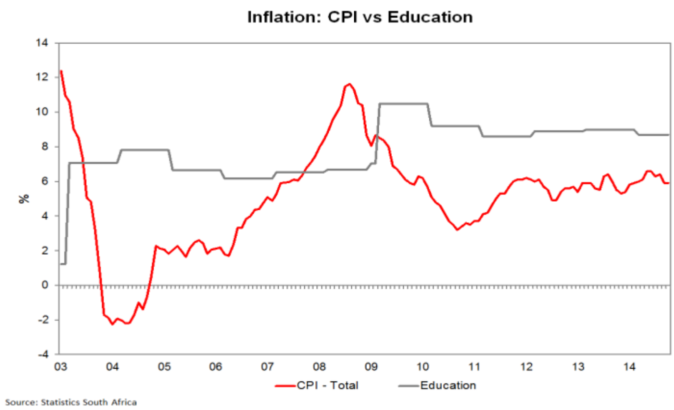

Inflation: CPI vs Goods vs Services
16
14
12
10
8
6
4
2
0
-2
-4
%
03 04 05 06 07 08 09 10 11 12 13 14
CPI - Total
CPI Goods
Services excl OER
Source: Statistics South Africa

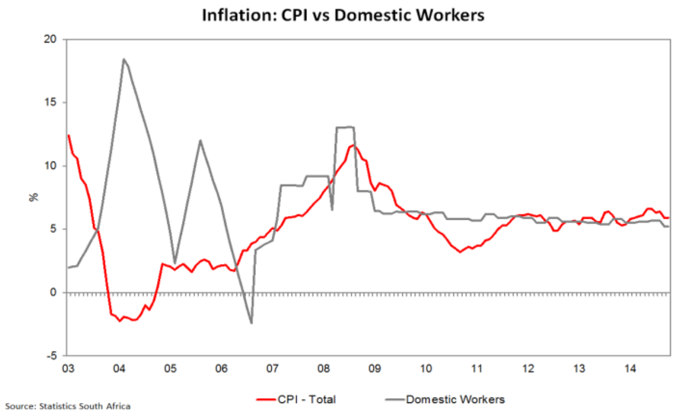

Inflation: CPI vs Services vs Retail
14
12
10
8
6
4
2
0
-2
-4
%
03 04 05 06 07 08 09 10 11 12 13 14
CPI - Total
Retail
Services excl OER
Source: Statistics South Africa

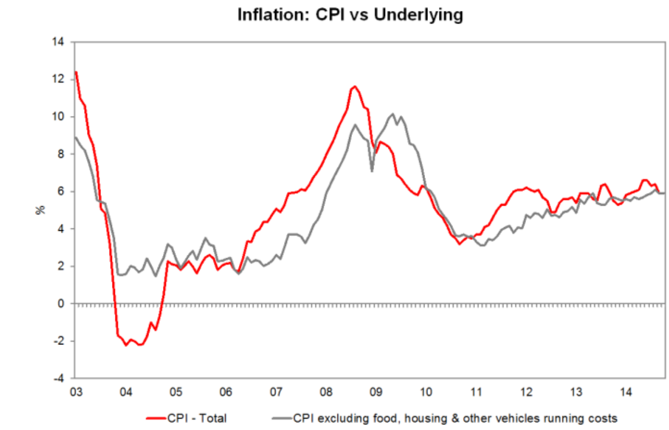

Inflation: CPI vs Clothing & Footwear
20
15
10
5
0
-5
-10
-15
%
03 04 05 06 07 08 09 10 11 12 13 14
CPI - Total
Clothing & Footwear
Source: Statistics South Africa


CPI Inflation: Total vs Vehicles
10
8
6
4
2
0
-2
%
09 10 11 12 13 14
CPI - Total
Vehicles
Source: Statistics South Africa


Inflation: CPI vs Health
14
12
10
8
6
4
2
0
-2
-4
%
03 04 05 06 07 08 09 10 11 12 13 14
CPI - Total
Health
Source: Statistics South Africa


Inflation: CPI vs Education
14
12
10
8
6
4
2
0
-2
-4
%
03 04 05 06 07 08 09 10 11 12 13 14
CPI - Total
Education
Source: Statistics South Africa


Inflation: CPI vs Domestic Workers
20
15
10
5
0
-5
%
03 04 05 06 07 08 09 10 11 12 13 14
CPI - Total
Domestic Workers
Source: Statistics South Africa



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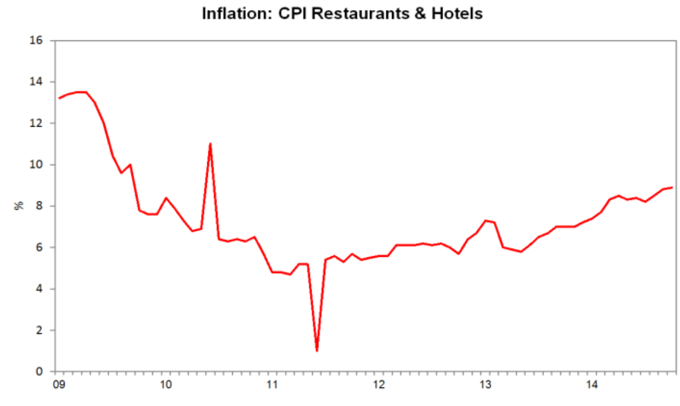

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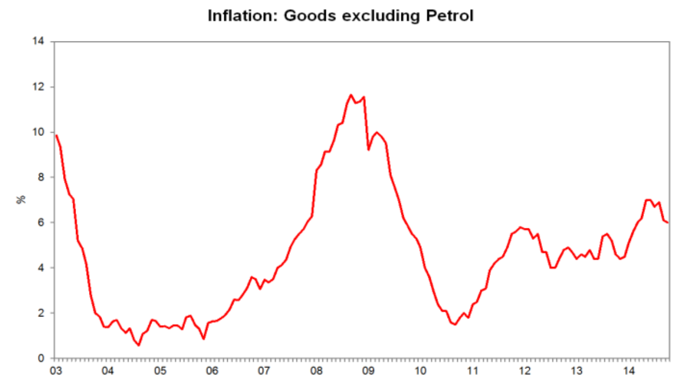

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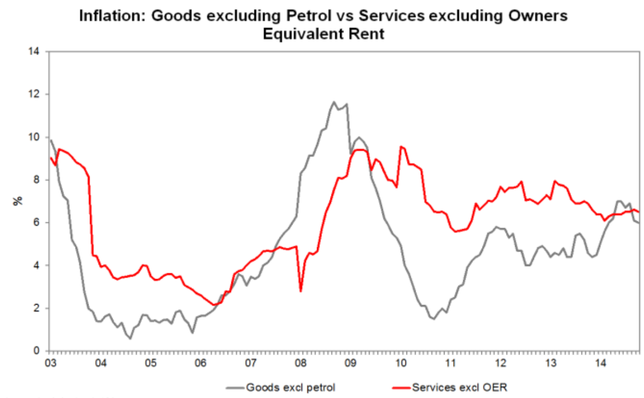

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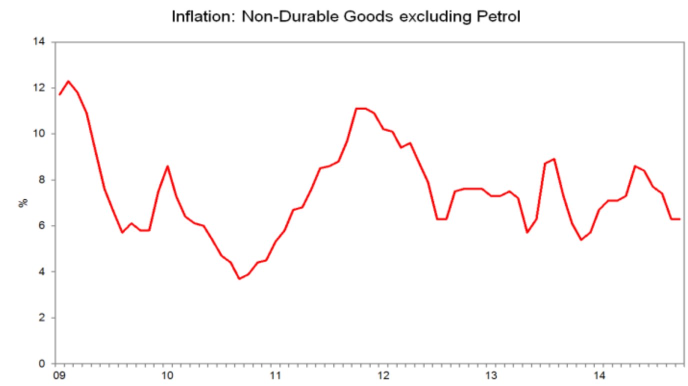

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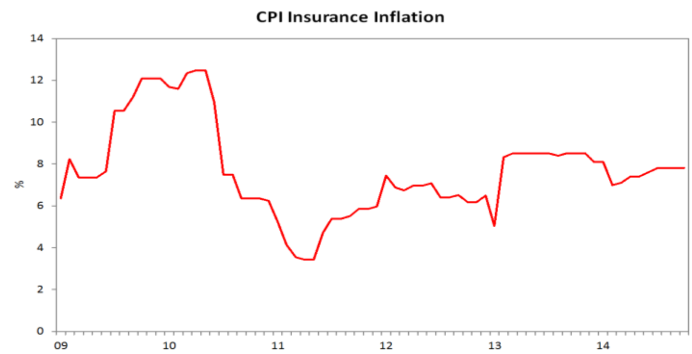

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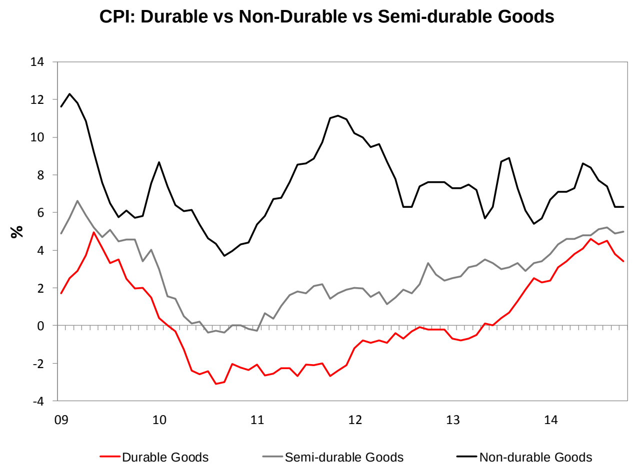

Source: StatsSA

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