Nedbank
Economic commentary

25 March 2009

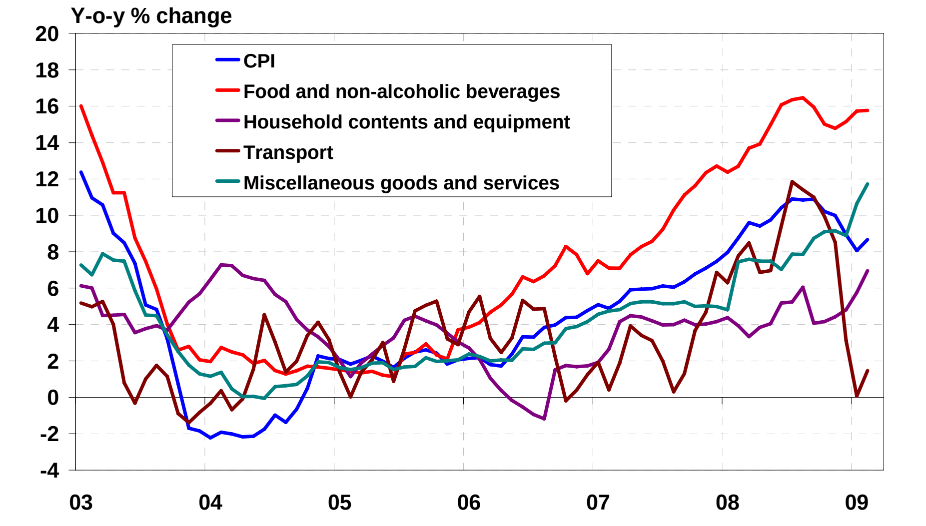
CONSUMER INFLATION

Service inflation drives inflation higher in February

Latest (February 2009)

Overall: 8,6% y-o-y, 1,2% m-o-m (8,1% y-o-y in January 2008)
Nedbank forecast: 8,2% y-o-y
Market forecast: 8,2% y-o-y

Graph 1: Consumer price inflation



Comment

February's inflation figure surprised on the upside as services inflation, which now has a much larger weighting in the new basket, increased sharply.

The higher-than-expected figure was mainly due to a steep increase in insurance and medical costs, which rose by 6,4% and 6,2% respectively over the month, contributing 0,6% to the month-on-month increase. Insurance and health services inflation tends to be backward looking, as they set prices infrequently and tend to use past inflation rather than expected inflation as a guide to setting prices. Fuel prices also rose over the month, resulting in a 10,5% m-o-m increase.

Interestingly, prices of durable goods, which have remained fairly static over the past few months, recorded their second month of slightly higher price increases. Prices of vehicles, household items and clothing rose by 0,6%, 0,8% and 0,9% m-o-m respectively. On an annual basis, prices of these items are also

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increasing. Although rand weakness in the fourth quarter would have increased the imported prices of many goods, it seems counterintuitive that retailers would pass this on to the consumer with demand for durable goods plummeting and unlikely to recover in the short term.

Food prices fell over the month for the first time since February 2007, with prices of grains and cereals, milk, oils and fats as well as fruit and vegetables all falling. Over the year, food inflation eased to 15,8% from 16,1%.

On and annual basis, miscellaneous goods and service inflation rose strongly to 13,3% from 12,3%, reflecting higher insurance costs as well as higher prices for personal care items such as shampoo and soap. Inflation at restaurants also rose, probably due to past food price increases.

Outlook

Our preliminary inflation forecast for March suggests a modest easing to 8,4%. March is a survey-heavy month, with survey results being released for owner's equivalent rent, rent, domestic worker wages as well as public transport. As a result, inflation could surprise on the upside. Fuel prices rose again in March, which will also add to the month-on-month increase.

Inflation is expected to ease over the coming months due to base effects, following the sharp run up in commodity prices last year and their subsequent decline. However, inflation could prove to be a lot stickier than was initially anticipated, particularly if retailers don't respond to weakening demand by cutting prices.

The inflation outlook will depend largely on four factors. First, the course of services inflation, which tends to be backward looking and may still rise this year reflecting last year's higher inflation. However, the contraction in demand for services in the fourth quarter suggests that insurers, hoteliers and restaurateurs may have to revise plans to increase prices much further this year.

Second, food prices which have proven to be extremely sticky over the past few months. February recorded the first decline in food prices in two years. Although it is too early to call an end to rising food prices, our monthly snap survey of food prices suggests that retailers continued to cut the prices of bread and grain related products as well as some meat products in March. However, the trend has yet to become widely entrenched.

The final two are the rand and energy prices.

A further weakening in domestic demand will eventually limit the extent to which retailers can hike prices and may even force some to consider cutting prices, in order to move stock off the shelves.

Implications

Today's inflation figure provides further evidence that, with the greater weighting of services in the basket inflation may not come down as quickly as initially anticipated. However, the Reserve Bank is likely to look beyond the next few month's inflation figures, which may continue to surprise on the upside. Rather, they will continue to focus on medium-term inflation outlook and the fast deteriorating prognosis for the domestic economy.

We therefore still anticipate a further 100 basis point cut in April, followed by an additional 250 to 200 basis points by August this year. Thereafter, much will depend on whether the economic news remains dismal or if there are tentative signs of both the domestic and global economy having turned the corner.

	CPI							
		February 2009					January 2009	
	Weights	Month-on-month		Year-on-year	Average	Average	Month	Year
		%	%	%	m-o-m	y-o-y	%	%
	Base 2008		contrib		past 3 yrs	past 3 yrs		
CPI for all urban areas	100	1.2	1.2	8.7	0.5	7.44	0.4	8.1
Food and non-alcoholic beverages	**15.68**	**0.2**	0.0	**15.8**	**0.1**	**11.86**	**1.9**	**15.7**
Food	14.27	-0.1	0.0	15.8	0.0	0.00	2.0	16.1
Bread and cereals	3.08	-0.3	0.0	23.8	1.5	17.41	-0.2	28.0
Meat	4.59	0.4	0.0	9.7	-0.7	10.13	2.2	7.9
Fish	0.66	0.2	0.0	19.7	-0.1	11.66	1.1	19.1
Milk, eggs and cheese	1.79	-0.1	0.0	14.0	0.3	12.91	1.7	15.2
Oils and fats	0.53	-1.9	0.0	25.6	0.2	22.01	0.1	30.8
Fruit	0.47	-0.6	0.0	8.9	-0.7	6.25	4.2	6.5
Vegetables	1.63	-0.7	0.0	19.3	-0.8	14.38	6.9	19.0
Sugar, sweets and deserts	0.77	0.3	0.0	13.4	0.0	8.09	2.1	13.3
Other	0.75	0.5	0.0	18.6	0.2	11.27	1.2	18.2
Non-alcoholic beverages	1.41	3.0	0.0	15.5	1.0	8.91	0.6	12.4
Alcoholic beverages and tobacco	**5.58**	**1.1**	0.1	**10.1**	**1.0**	**8.61**	**0.2**	**10.3**
Alcoholic beverages	3.29	0.9	0.0	7.5	1.3	7.00	0.4	8.7
Tobacco	2.29	1.2	0.0	14.1	0.4	10.86	0.1	12.7
Clothing and footwear	**4.11**	**0.9**	0.0	**4.6**	**0.1**	**1.25**	**0.9**	**3.8**
Clothing	2.9	1.0	0.0	5.1	0.2	1.37	0.9	4.3
Footwear	1.21	0.4	0.0	3.4	-0.2	0.94	1.0	3.0
Housing and utilities	**22.56**	**0.0**	0.0	**9.1**	**0.0**	**10.38**	**0.1**	**9.2**
Actual rentals for housing	3.49	0.0	0.0	8.1	0.2	9.02	0.0	8.1
Owners equivalent rent	12.21	0.0	0.0	0.0	0.0	0.00	0.0	0.0
Maintenance and repairs	1.68	0.6	0.0	16.8	0.3	10.82	0.8	16.3
Water and other services	3.31	0.0	0.0	0.0	0.0	0.00	0.0	0.0
Electricity and other fuels	1.87	-0.2	0.0	30.3	-0.1	15.22	-0.3	30.5
Household contents and equipment	**5.86**	**0.8**	0.0	**7.0**	**0.2**	**4.51**	**1.2**	**5.8**
Furnishings, floor coverings and textiles	2.17	0.5	0.0	1.3	-0.1	-1.41	0.6	0.3
Appliances, tableware and equipment	1.05	2.5	0.0	14.6	0.6	5.56	4.6	10.8
Supplies and services	2.64	0.4	0.0	8.7	0.2	7.44	0.1	8.3
Domestic workers wages	1.99	0.0	0.0	6.5	0.0	7.14	0.0	6.5
Health	**1.47**	**6.2**	0.1	**9.2**	**3.7**	**7.59**	**0.2**	**7.7**
Transport	**18.8**	**1.8**	0.3	**1.5**	**0.4**	**3.21**	**-3.1**	**0.1**
Purchase of vehicles	11.25	0.6	0.1	1.9	0.2	-0.71	0.2	1.2
Private transport operation	4.82	7.9	0.4	-8.3	2.5	5.95	-14.1	-13.4
Petrol	3.93	10.5	0.4	-14.0	3.1	6.21	-18.8	-20.3
Other running costs	0.89	1.1	0.0	14.2	0.4	9.11	1.9	13.0
Public Transport	2.73	-0.6	0.0	15.7	-0.4	6.12	-0.4	16.9
Communication	**3.22**	**-0.1**	0.0	**0.7**	**-0.1**	**0.03**	**0.2**	**0.7**
Recreation and culture	**4.19**	**1.0**	0.0	**9.7**	**0.2**	**3.14**	**1.2**	**8.6**
Education	**2.19**	**0.0**	0.0	**7.0**	**0.0**	**6.58**	**0.0**	**7.0**
Restaurants and hotels	**2.78**	**0.9**	0.0	**13.4**			**0.4**	**13.2**
Miscellaneous goods and services	**13.56**	**3.7**	0.5	**11.7**	**2.2**	**7.96**	**2.8**	**10.6**
Personal Care	2.20	1.5	0.0	13.3	0.8	7.83	1.9	12.3
Insurance	7.71	6.4	0.5	8.2	3.7	6.98	1.4	6.4
Financial Services	1.27	0.0	0.0	17.1	0.0	11.08	3.7	17.1
Other Services	2.38	0.0	0.0	19.4	0.1	8.10	7.4	19.4

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