

Nedbank

Economic commentary

28 January 2010

PRODUCER INFLATION

Producer inflation returns

- The monthly increase was due to higher agricultural and commodity prices.
- Producer inflation is likely to remain subdued during 2010
- We expect interest rates to remain unchanged until early 2011

Latest (December 2009)

Headline PPI: 0,7% y-o-y, 0,7% m-o-m (-1,2% y-o-y in November 2009)

Market forecast: 0,4% y-o-y

Nedbank forecast: 0,8% y-o-y

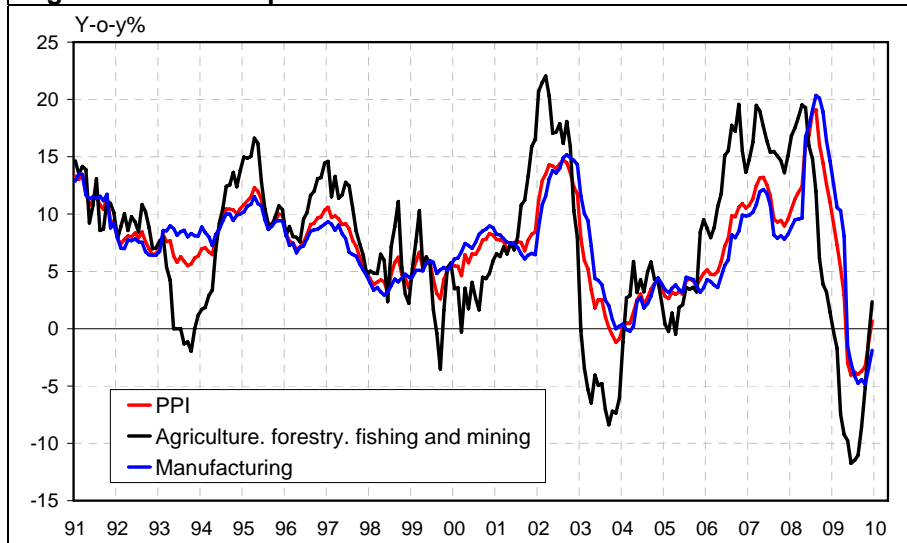
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Figure 1: Producer price inflation



Source: Stats SA

Comment

Producer price inflation returned for the first time since April 2009, due to higher commodity prices, which have been rising steadily since February 2009. *The Economist* commodity price index has risen by 40% since December 2008, when commodity prices were nearly at record lows. The full impact of higher commodity prices on South African producer inflation has been muted to some extent by the strength of the rand.

Food prices at the agricultural level rose by 3,5% m-o-m in December, but are still 2,3% lower than this time last year. Sharply higher prices of vegetables and oil seeds were the main reason behind the monthly increase.

The mining and quarrying category rose by 3,6% y-o-y, up from -0,7% in the previous month. Over the month, the category rose by 1,7%, due to higher metal ore prices.

Food prices at the manufacturing level declined by 0,5% m-o-m, following a 0,2% m-o-m gain in the previous month. Since peaking in April 2009, prices are down nearly 2%. This bodes well for a further moderation in food inflation at the consumer level.

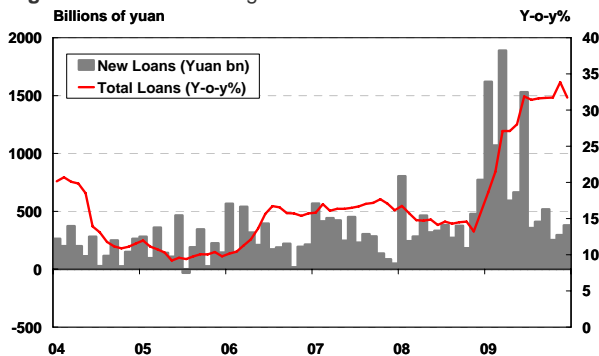
Outlook

Producer inflation is expected to remain subdued during 2010. Weak global and domestic demand for capital goods and industrial materials, due to low levels of investment and construction spending, will contain price increases.

The outlook for commodity prices is generally more benign, following last year’s sharp rebound.

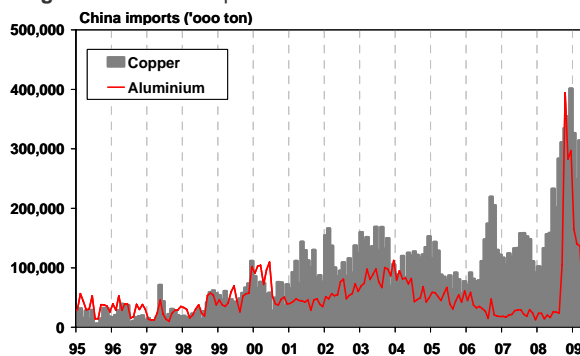
Recent remarks by Chinese officials that the economy may be over heating, has prompted a move to stem bank lending and could result in the policy rate rising shortly. Chinese stockpiling of commodities during 2009 as well as 30% annual growth in fixed asset investment were among the drivers of the rebound in commodity prices. Slower Chinese growth combined with more bearish market sentiment could put some downward pressure on commodity prices, or at least limit upside price increases.

Figure 2: Chinese credit growth



Source: DataStream

Figure 3: Chinese imports



In addition to this, inventories have continued to expand, suggesting that real demand has yet to recover fully¹.

There are two main sources of risk to our benign outlook for producer price inflation in 2010. The first, if granted, is Eskom’s proposed 35% tariff increase. Electricity makes up 6,7% of the basket. A weaker rand also poses a concern, particularly if the recent shift in market sentiment, turns out to be a more permanent.

Implications

The return of domestic producer price inflation reflects higher commodity prices, rather than demand-side pressures. As a result, today’s producer inflation has no short-term negative implications for consumer inflation.

The MPC’s current stance supports our view that any idea that demand-led inflation, at either the producer or consumer level, is about to resurface is hopelessly optimistic, given significant overcapacity and unemployment. The risk to inflation remains on the cost-push side, with the threat of Eskom’s price hikes the key danger. However, these – if they materialise – would just punish consumers and businesses more and consequently hurt growth prospects.

We believe that the MPC will remain cautious and therefore keep rates flat in 2010 before starting to tighten in 2011.

¹ As reported by the London Metal Exchange

	Headline PPI							
	Weights Base 2000	December 2009				Ave m-o-m past 3 yrs	December 2008	
		Month-on-month		Year-on-year			M-o-m %	Y-o-y %
		%	% contrib	%	% contrib			
Total	100.0	0.7	0.7	0.7	0.66	0.0	0.8	-1.2
Agriculture, forestry, fishing and mining	29.4	1.8	0.53	2.4	0.69	0.0	2.7	-0.8
Agriculture	8.2	2.3	0.19	1.2	0.10	0.0	2.1	0.9
Food	3.9	3.5	0.14	-2.3	-0.09	0.0	2.5	-3.6
Grain	0.9	2.4	0.02	-6.3	-0.05	0.0	1.8	-6.5
Vegetables	1.1	-0.4	0.00	-1.1	-0.01	0.0	-2.7	4.8
Fruits & nuts	1.4	7.5	0.11	-3.1	-0.04	0.0	7.8	-8.9
Oil seeds	0.1	14.7	0.02	-11.7	-0.02	0.0	13.4	-26.9
Sugar cane	0.3	-0.1	0.00	16.3	0.05	0.0	-0.4	17.6
Other food	0.0	2.9	0.00	18.2	0.01	0.0	0.0	14.8
Live animals & animal products	3.7	1.8	0.06	4.5	0.17	0.0	1.7	5.4
Nursery products & other agriculture	0.7	-3.4	-0.02	7.6	0.05	0.0	2.2	7.0
Forestry	1.5	0.8	0.01	-5.1	-0.08	0.0	1.9	-9.0
Fishing	0.3	0.0	0.00	-11.3	-0.03	0.0	0.2	-10.2
Mining & quarrying	19.4	1.7	0.33	3.6	0.70	0.0	3.0	-0.7
Coal & lignite	5.0	0.1	0.01	6.1	0.30	0.0	4.3	14.4
Crude petroleum & natural gas	0.6	-1.4	-0.01	11.9	0.07		2.1	3.2
Metal ores	11.5	2.9	0.33	5.7	0.65	0.0	2.7	-4.2
Other minerals	2.3	0.0	0.00	-17.9	-0.42	0.0	0.6	-24.1
Manufacturing	62.3	0.4	0.24	-1.9	-1.17	0.0	0.1	-3.5
Food at manufacturing	5.9	-0.5	-0.03	-1.5	-0.09	0.0	0.2	-1.1
Beverages	3.0	0.0	0.00	5.5	0.17	0.0	0.1	5.5
Tobacco products	0.6	0.0	0.00	13.8	0.08	0.0	0.0	13.8
Textiles & made-up goods	1.1	0.2	0.00	3.5	0.04	0.0	0.0	3.9
Wearing apparel	1.5	0.0	0.00	1.1	0.02	0.0	0.0	1.1
Leather & leather products	0.3	0.0	0.00	1.1	0.00	0.0	0.0	1.1
Footwear	0.3	0.0	0.00	4.4	0.01	0.0	-0.1	4.4
Wood & wood products	1.4	0.0	0.00	1.4	0.02	0.0	0.0	1.4
Paper & paper products	5.0	0.1	0.00	4.9	0.24	0.0	-0.1	5.0
Products of petroleum & coal	5.0	3.8	0.19	0.0	0.00	0.0	-0.2	-15.8
Chemicals & chemical products	6.7	0.0	0.00	-6.2	-0.42	0.0	-0.1	-6.4
Rubber & plastic products	2.6	0.2	0.00	-3.3	-0.08	0.0	0.1	-3.6
Non-metallic mineral products	2.0	1.2	0.02	6.8	0.13	0.0	0.5	5.6
Basic metals	6.7	0.1	0.01	-12.3	-0.82	0.0	0.6	-12.5
Metal products	3.3	0.0	0.00	0.7	0.02	0.0	-0.6	0.2
Non-electrical machinery & equipment	2.4	0.0	0.00	0.3	0.01	0.0	0.0	0.3
Office, accounting & computing machinery	0.2	0.0	0.00	0.0	0.00	0.0	0.0	0.0
Electrical machinery & apparatus	1.9	0.1	0.00	1.1	0.02	0.0	0.4	1.1
Radio, TV & communication equipment	0.5	0.0	0.00	-0.6	0.00	0.0	-0.5	-0.6
Medical appliances, instruments & clocks	0.3	0.0	0.00	2.6	0.01	0.0	0.0	3.0
Transport	5.8	0.0	0.00	0.8	0.04	0.0	0.1	0.8
Furniture	1.0	0.0	0.00	4.2	0.04	0.0	0.3	4.4
Other manufactures	5.0	-0.1	-0.01	-0.8	-0.04	0.0	0.6	-0.7
Electricity, gas and water	8.3	-0.4	-0.03	16.3	1.36	0.0	-0.1	17.6

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