

Comment

Inflation surprised sharply on the downside in June, coming in at 4,2%, compared with market expectations of 4,5%. Lower food prices and a decline in insurance costs, which make up 7,7% of the basket, were the two main reasons for the surprise figure.

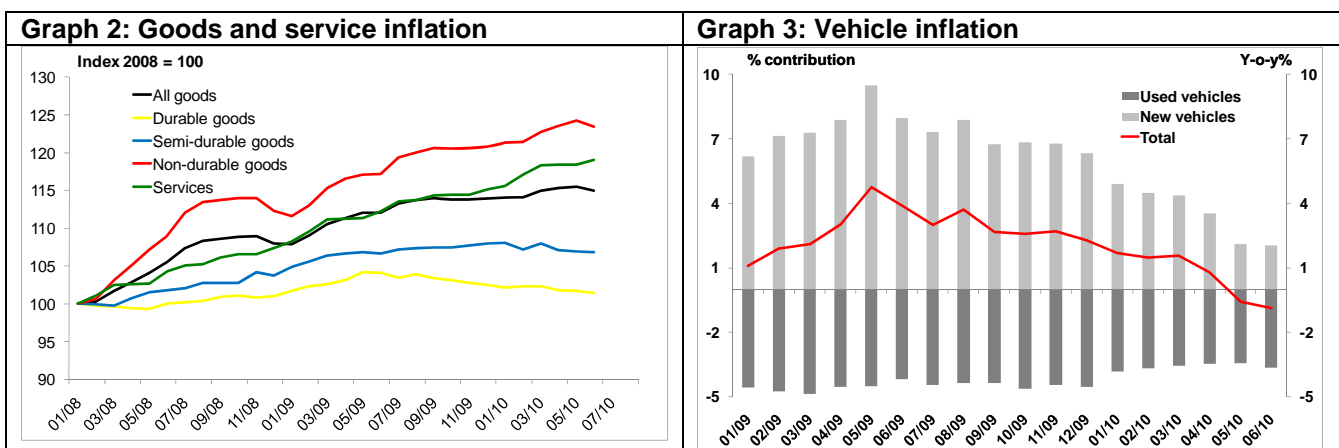
Food prices fell by 0,5% m-o-m and recorded no inflation on an annual basis. The monthly decline was due to a 5,4% fall in fruit prices, as well as lower prices for grains, meat and sugar.

Insurance costs also came down sharply over the month, falling by 1,2%. Over the year, insurance inflation eased to 10,9% from 12,4% in the previous month. Personal care items also fell over the month, declining by 1%, taking the annual increase to 1,7%.

Prices of durable and semi-durable goods continued to decline, with car prices falling by 0,2% m-o-m and 0,9% y-o-y, while furniture prices also declined on both a monthly and annual basis. The cost of telecommunication equipment fell by 2,5% over the month, while prices of books and stationary were 1,2% lower.

Housing costs, which contribute over 15% to the inflation basket, was the main source of upward pressure over the month. Owner's equivalent rent and actual rentals rose by 1,1% m-o-m and 1,5% respectively. However, inflation in both categories moderated on an annual basis.

Outlook



July's inflation will mainly be driven by the 25% increase in electricity prices, which will add 0,46 percentage points to the monthly increase of around 1%. Thereafter, inflation is expected to pick up slightly, ending the year around 5% as some degree of opportunistic pricing surfaces on the back of a likely pickup in consumer spending. However, a strong rand and disinflation abroad will help to contain price pressure.

Services inflation which is backward looking, should moderate further as companies set prices based on inflation which has now fallen well below the upper-end of the target band.

Food inflation is expected to remain subdued during the rest of the year. Recent agricultural trends suggest that food price increases are likely to stay subdued. A good harvest globally and expectations of a bumper harvest locally will help to contain upward pressure on maize prices, despite an increase in global maize demand driven by rising demand for biofuels and feedstock. Global wheat prices are forecast to stay stable, albeit with some modest upward pressure, due to concerns about a drier planting season as well as a smaller area under plantation, as concerns over drought and low prices convince farmers to plant less. An increase in sunflower seed production in the coming season, both locally and globally, should help to contain price increases¹.

¹ Information provided by Nedsec

The medium-term inflation outlook is clouded by recent above-inflation wage settlements, which could turn into higher inflation, if productivity does not increase. This would exert upward pressure on interest rates and have negative implications for long-term growth.

Implication

Although we still expect the MPC to leave interest rates unchanged, today's better-than-expected inflation figure has increased the chance that the SARB may decide to cut interest rates at the next meeting, particularly if the rand continues to strengthen. Much now depends on whether the next set of economic data shows that the recovery remains strong, or whether it is beginning to lose some steam.

	CPI							
	Weights Base 2008	June 2010				May 2010		
		Month-on-month %	Year-on-year % contrib	Average m-o-m past 3 yrs	Average y-o-y past 3 yrs	Month %	Year %	
CPI for all urban areas	100	0.0	0.0	4.2	0.6	7.18	0.2	4.6
Food and non-alcoholic beverages	15.68	-0.4	-0.1	0.7	0.3	9.00	0.5	0.8
Food	14.27	-0.5	-0.1	0.0	0.3		0.4	0.1
Bread and cereals	3.08	-0.7	0.0	-3.5	1.2	11.19	-0.1	-3.0
Meat	4.59	-0.6	0.0	-1.5	0.2	5.60	0.2	-1.1
Fish	0.66	0.5	0.0	4.6	0.9	8.74	0.2	4.0
Milk, eggs and cheese	1.79	-0.1	0.0	2.2	0.1	11.18	0.7	2.6
Oils and fats	0.53	0.0	0.0	-5.2	0.6	14.98	1.6	-6.1
Fruit	0.47	-5.4	0.0	3.7	-4.8	8.88	-5.6	2.5
Vegetables	1.63	1.7	0.0	3.2	0.2	10.47	2.6	0.8
Sugar, sweets and deserts	0.77	-1.2	0.0	5.3	0.1	9.79	1.1	6.7
Other	0.75	-0.4	0.0	2.6	0.5	11.48	-0.1	3.2
Non-alcoholic beverages	1.41	-0.2	0.0	7.2	0.3	10.39	0.8	7.4
Alcoholic beverages and tobacco	5.58	-0.2	0.0	10.8	0.0	9.64	0.2	11.0
Alcoholic beverages	3.29	-0.3	0.0	6.3	0.0	7.45	0.4	6.5
Tobacco	2.29	0.0	0.0	17.0	0.1	12.68	0.0	17.1
Clothing and footwear	4.11	0.0	0.0	2.0	0.2	6.31	0.1	2.3
Clothing	2.9	0.0	0.0	2.0	0.2	6.33	0.1	2.2
Footwear	1.21	0.1	0.0	2.0	0.1	6.12	0.1	2.2
Housing and utilities	22.56	0.8	0.2	6.7	1.2	8.76	0.1	6.9
Actual rentals for housing	3.49	1.5	0.1	4.5	2.0	6.36	0.0	4.9
Owners equivalent rent	12.21	1.1	0.1	3.9	1.5	1.29	0.0	4.2
Maintenance and repairs	1.68	0.0	0.0	4.2	0.7	10.60	0.4	4.6
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	0.1	0.0	24.7	0.2	20.67	0.0	24.4
Household contents and equipment	5.86	0.8	0.0	-0.3	0.9	3.96	-0.3	-0.1
Furnishings, floor coverings and textile	2.17	-0.6	0.0	-4.5	-0.3	-2.04	-0.5	-4.4
Appliances, tableware and equipment	1.05	0.5	0.0	-3.7	0.4	4.55	-0.2	-3.9
Supplies and services	2.64	1.7	0.0	4.3	1.9	7.94	0.0	4.9
Domestic workers wages	1.99	2.3	0.0	5.8	2.6	7.58	0.0	6.3
Health	1.47	0.6	0.0	7.1	0.2	9.40	0.1	6.4
Transport	18.8	-0.8	-0.1	2.2	1.0	3.15	0.3	3.5
Purchase of vehicles	11.25	-0.2	0.0	-0.9	0.3	0.64	0.0	-0.6
Private transport operation	4.82	-2.4	-0.1	10.6	1.3	8.14	1.2	15.3
Petrol	3.93	-3.2	-0.1	12.5	1.5	8.47	1.7	18.8
Other running costs	0.89	0.1	0.0	4.2	0.3	9.21	0.1	4.3
Public Transport	2.73	0.1	0.0	2.0	3.8	6.72	-0.2	2.8
Communication	3.22	-0.2	0.0	-1.2	-0.2	-0.27	-0.2	-1.3
Recreation and culture	4.19	-0.4	0.0	-1.3	-0.3	4.67	-0.2	-1.2
Education	2.19	0.0	0.0	9.2	0.0	8.92	0.0	9.2
Restaurants and hotels	2.78	4.3	0.1	11.0			0.5	6.9
Miscellaneous goods and services	13.56	-0.9	-0.1	7.4	-0.2	8.73	0.1	8.6
Personal Care	2.20	-1.0	0.0	1.7	-0.2	7.86	0.6	2.9
Insurance	7.71	-1.2	-0.1	10.9	-0.4	9.02	0.0	12.4
Financial Services	1.27	0.0	0.0	4.4	0.1	10.04	0.0	4.7
Other Services	2.38	0.0	0.0	4.0	0.0	8.34	0.0	4.0

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