

# Nedbank

## Economic commentary

23 June 2010

### CONSUMER INFLATION

#### *Inflation eases further*

- Consumer inflation eased to its lowest level since May 2006, slowing to 4,6% in May from 4,8% in April, in line with market expectations.
- Downward pressure on inflation came from lower food prices as well as a further moderation in goods inflation, particularly durable and semi-durable goods.
- Double-digit administered price inflation remains the main driver of headline inflation.
- The inflation cycle is forecast to turn in the second half of the year as Eskom's 25% tariff hike comes into effect and some degree of opportunistic pricing surfaces as consumer spending picks up slightly.
- Although we still expect interest rates to remain on hold well into 2011, the MPC may surprise by easing further in July, given the near-term improvement in inflation and inflation expectations, particularly if growth figures start to disappoint.

#### Latest (May 2010)

Overall: 4,6% y-o-y, 0,2% m-o-m (4,8% y-o-y in April 2010)

Nedbank forecast: 4,6% y-o-y

Market forecast: 4,6% y-o-y

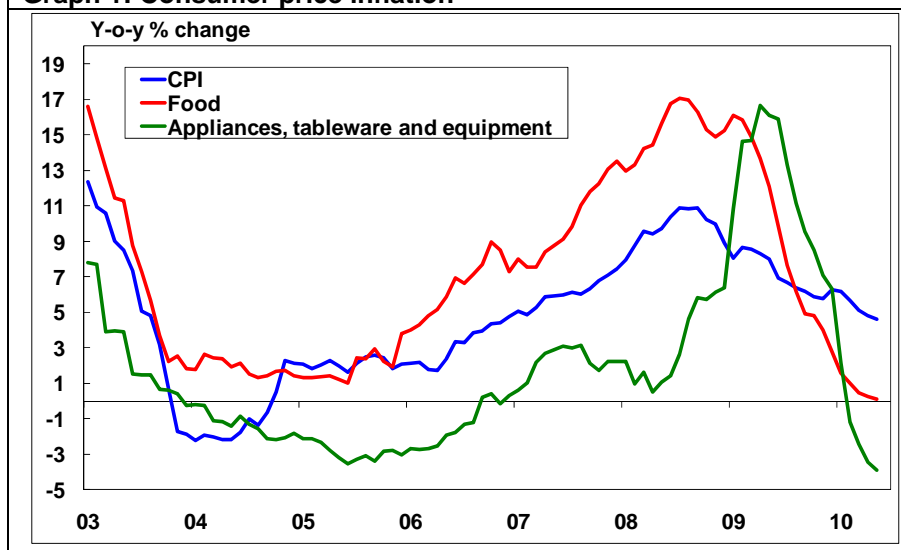
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**Graph 1: Consumer price inflation**



#### Comment

Inflation eased further to 4,6% in May, its lowest level since May 2006, due to lower prices of durable and semi-durable goods as well as a further moderation in food inflation.

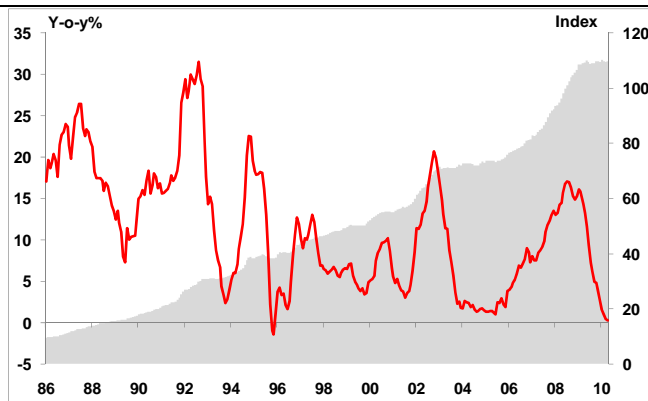
Falling prices for durable and semi-durable goods suggest that retailers' continued to cut prices in order to move stock off the shelves. Durable goods prices fell by 2,4% y-o-y, following a decline of 1,3% y-o-y in April, mainly due furniture, appliance and vehicle deflation. The price of second-hand vehicles has fallen by more than 10% y-o-y. Semi-durable goods inflation eased further to 0,1% y-o-y, down from 0,5% y-o-y in the previous month.

Food prices rose by 0,4% over the month, mainly due to a 0,5% m-o-m increase in processed food. Food inflation eased to 0,1%, its lowest level since 1995, as a result of deflation in the unprocessed goods category.

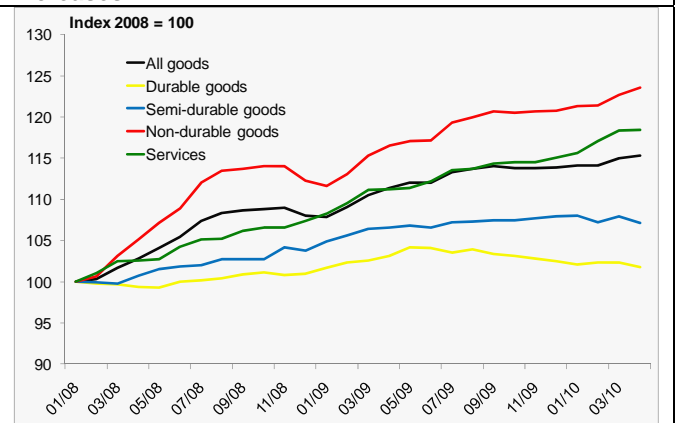
The main upward pressure on headline inflation continued to come from administered price inflation, which increased to 12,1% y-o-y, up from 11,6% y-o-y in the previous month.

## Outlook

**Figure 2: Food price inflation**



**Figure 3: Non-durables and services drive price increases**



The inflation cycle is forecast to turn in the second half of the year as Eskom's 25% tariff hike comes into effect and some degree of opportunistic pricing surfaces as consumer spending picks up slightly.

Food price inflation reached its lowest level since 1995 in May, with inflation in this category expected to remain subdued during the rest of the year. Recent agricultural trends, suggests 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 global, should help to contain price increases<sup>1</sup>.

The medium-term inflation outlook is clouded by recent wage settlements, with the latest data on average monthly earnings, showing a 16% y-o-y increase, while employment contracted by 2,9% over the same period and inflation for low and middle income earners stood at roughly 3%. This is concerning, not only because it shows that labour's wage demands are largely insensitive to the economic cycle, muting the normal adjustment mechanism whereby lower labour costs (due to constrained wage increases and retrenchments) enable companies' to contain costs and cut prices, helping to kick start demand. It could also result in rising inflation, if productivity does not increase. This would exert upward pressure on interest rates and have negative implications for long-term growth.

The latest BER inflation expectation's survey also shows a worrying trend, a divergence between analysts' expectations and those of business, which ultimately controls price setting within the economy. Analysts and business currently anticipate average inflation of 5,9% and 7,2% for 2010 respectively. For business to be correct, it assumes that inflation would have to end the year at roughly 10%, which seems unlikely.

<sup>1</sup> Information provided by Nedsec

## Implication

Although we still expect interest rates to remain on hold well into 2011, the MPC may surprise by easing further in July, given the near-term improvement in inflation and inflation expectations, particularly if growth figures start to disappoint.

	CPI							
	Weights	May 2010				April 2010		
		Base 2008	Month-on-month %	% contrib	Year-on-year %	Average m-o-m past 3 yrs	Average y-o-y past 3 yrs	Month %
<b>CPI for all urban areas</b>	100	0.2	0.2	4.6	0.4	7.44	0.2	4.8
<b>Food and non-alcoholic beverages</b>	<b>15.68</b>	<b>0.5</b>	<b>0.1</b>	<b>0.8</b>	<b>0.9</b>	<b>9.36</b>	<b>0.1</b>	<b>0.9</b>
Food	14.27	0.4	0.1	0.1	1.0		0.2	0.3
Bread and cereals	3.08	-0.1	0.0	-3.0	2.0	11.90	-0.2	-3.0
Meat	4.59	0.2	0.0	-1.1	0.6	5.68	0.0	-0.6
Fish	0.66	0.2	0.0	4.0	0.9	8.97	-0.4	4.1
Milk, eggs and cheese	1.79	0.7	0.0	2.6	0.9	12.40	-0.4	3.3
Oils and fats	0.53	1.6	0.0	-6.1	0.9	15.23	-0.9	-9.2
Fruit	0.47	-5.6	0.0	2.5	-3.9	8.66	3.9	6.5
Vegetables	1.63	2.6	0.0	0.8	1.2	10.98	0.8	-1.4
Sugar, sweets and deserts	0.77	1.1	0.0	6.7	1.2	10.44	0.3	6.8
Other	0.75	-0.1	0.0	3.2	1.2	11.71	0.0	5.5
Non-alcoholic beverages	1.41	0.8	0.0	7.4	0.7	10.57	-0.1	7.6
<b>Alcoholic beverages and tobacco</b>	<b>5.58</b>	<b>0.2</b>	<b>0.0</b>	<b>11.0</b>	<b>0.2</b>	<b>10.20</b>	<b>0.4</b>	<b>10.9</b>
Alcoholic beverages	3.29	0.4	0.0	6.5	0.3	7.62	0.4	6.3
Tobacco	2.29	0.0	0.0	17.1	0.2	13.76	0.4	17.3
<b>Clothing and footwear</b>	<b>4.11</b>	<b>0.1</b>	<b>0.0</b>	<b>2.3</b>	<b>0.1</b>	<b>6.14</b>	<b>0.1</b>	<b>2.3</b>
Clothing	2.9	0.1	0.0	2.2	0.2	6.06	0.1	2.3
Footwear	1.21	0.1	0.0	2.2	0.1	6.08	0.0	2.2
<b>Housing and utilities</b>	<b>22.56</b>	<b>0.1</b>	<b>0.0</b>	<b>6.9</b>	<b>0.1</b>	<b>9.12</b>	<b>0.0</b>	<b>6.8</b>
Actual rentals for housing	3.49	0.0	0.0	4.9	0.0	6.37	0.0	4.9
Owners equivalent rent	12.21	0.0	0.0	4.2	0.0	1.41	0.0	4.2
Maintenance and repairs	1.68	0.4	0.0	4.6	0.9	10.60	0.3	4.5
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	0.0	0.0	24.4	-0.1	20.72	0.1	24.3
<b>Household contents and equipment</b>	<b>5.86</b>	<b>-0.3</b>	<b>0.0</b>	<b>-0.1</b>	<b>0.1</b>	<b>3.65</b>	<b>-0.3</b>	<b>0.6</b>
Furnishings, floor coverings and textile	2.17	-0.5	0.0	-4.4	-0.3	-2.01	-0.5	-3.7
Appliances, tableware and equipment	1.05	-0.2	0.0	-3.9	0.3	4.44	-0.4	-3.4
Supplies and services	2.64	0.0	0.0	4.9	0.4	7.34	0.0	5.4
Domestic workers wages	1.99	0.0	0.0	6.3	0.0	6.74	0.0	6.3
<b>Health</b>	<b>1.47</b>	<b>0.1</b>	<b>0.0</b>	<b>6.4</b>	<b>0.3</b>	<b>9.23</b>	<b>0.2</b>	<b>6.5</b>
<b>Transport</b>	<b>18.8</b>	<b>0.3</b>	<b>0.1</b>	<b>3.5</b>	<b>0.8</b>	<b>3.65</b>	<b>1.2</b>	<b>4.0</b>
Purchase of vehicles	11.25	0.0	0.0	-0.6	0.4	0.65	-0.2	0.8
Private transport operation	4.82	1.2	0.1	15.3	2.0	9.55	4.9	13.5
Petrol	3.93	1.7	0.1	18.8	2.5	10.35	6.1	16.3
Other running costs	0.89	0.1	0.0	4.3	0.5	9.49	0.3	4.6
Public Transport	2.73	-0.2	0.0	2.8	0.3	6.73	1.1	3.4
<b>Communication</b>	<b>3.22</b>	<b>-0.2</b>	<b>0.0</b>	<b>-1.3</b>	<b>0.0</b>	<b>-0.25</b>	<b>-0.2</b>	<b>-1.1</b>
<b>Recreation and culture</b>	<b>4.19</b>	<b>-0.2</b>	<b>0.0</b>	<b>-1.2</b>	<b>0.7</b>	<b>4.90</b>	<b>-1.7</b>	<b>-0.5</b>
<b>Education</b>	<b>2.19</b>	<b>0.0</b>	<b>0.0</b>	<b>9.2</b>	<b>0.0</b>	<b>8.92</b>	<b>0.0</b>	<b>9.2</b>
<b>Restaurants and hotels</b>	<b>2.78</b>	<b>0.5</b>	<b>0.0</b>	<b>6.9</b>			<b>0.2</b>	<b>6.8</b>
<b>Miscellaneous goods and services</b>	<b>13.56</b>	<b>0.1</b>	<b>0.0</b>	<b>8.6</b>	<b>0.1</b>	<b>9.21</b>	<b>0.1</b>	<b>8.6</b>
Personal Care	2.20	0.6	0.0	2.9	0.7	8.35	0.1	3.1
Insurance	7.71	0.0	0.0	12.4	0.0	9.49	0.1	12.4
Financial Services	1.27	0.0	0.0	4.7	0.0	10.70	0.0	4.7
Other Services	2.38	0.0	0.0	4.0	0.0	8.41	0.0	4.0

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