

28 October 2010

Economic Commentary

Producer inflation

Producer inflation comes in below market expectations

- Producer inflation came in well below forecast, at 6,8% y-o-y down from 7,8% y-o-y in August.
- Lower agricultural and industrial commodity prices as well as the seasonal decline in electricity costs were the main factors behind the monthly decline.
- Further gains in industrial commodity prices are likely to be limited in the short term, due to the slowdown in global growth and ample stockpiles. However, with the increased likelihood of another round of quantitative easing in the US and continued growth in key commodity-consuming countries like China, there is a risk of price increases in the new year.
- Weak demand, both locally and globally, low input costs as well as the strong rand will help to contain price increases of manufactured goods.
- We expect the Reserve Bank's Monetary Policy Committee to pause over the next two meetings, with a possible 50 basis point cut in March next year. However, the continued improvement in the inflation outlook as well as the strength of the rand may prompt them to act sooner.

Table 1 : Producer inflation

| | September Y-o-y% | September M-o-m% | August Y-o-y% | Nedbank Forecast Y- o-y% | Market Forecast Y-o-y% |
|-------|---------------------|---------------------|------------------|--------------------------------|------------------------------|
| Total | 6,8 | -4,1 | 7,8 | 8,9 | |

Source: StatsSA

Comment

Producer inflation surprised on the downside in September, slowing to 6,8% y-o-y, down from 7,8% in August and against market expectations of 8%. Lower prices for agricultural and industrial commodities as well as the seasonal decline in electricity costs were the main factors contributing towards the 4,1% decline in prices over the month.

Food prices at the agricultural level fell by 2,4% m-o-m, due to seasonal declines in the prices of fruits (down 3,3% m-o-m) and vegetables (down 11% m-o-m). Agricultural food prices continued to decline on an annual basis. At the manufacturing level, food prices rose by a modest 0,3% m-o-m, mainly due to higher prices for grain and dairy products.

The strong rand and weaker global demand continued to put downward pressure on commodity prices, with the mining and quarrying category falling by 0,9% m-o-m. The price of metal ores fell by 2,1% over the month, while 'other metals' fell by 1,2%.

Electricity prices fell by 32,8% m-o-m, as the higher winter-season tariffs came to an end in September.

Inflation at the manufacturing level remains subdued at 2,6% y-o-y (0,2% m-o-m), up from 2,5% y-o-y in August.

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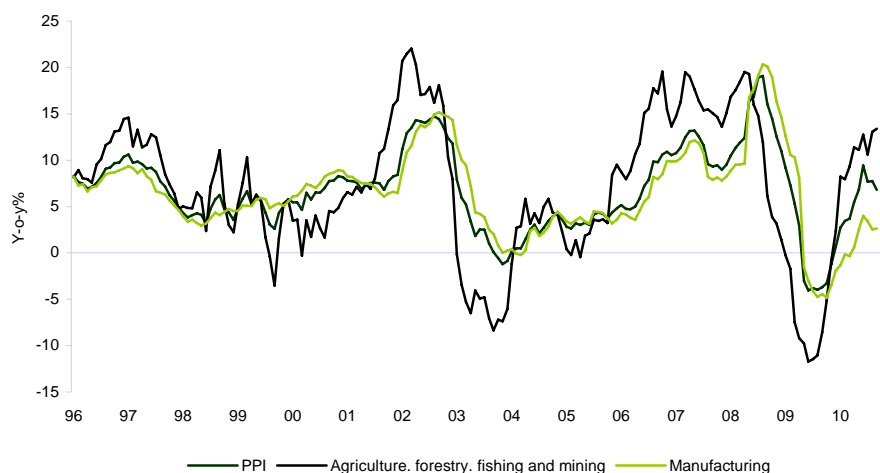
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Important disclosures can be found in the Disclosures Appendix.

Chart 1 : Producer inflation

Source: StatsSA

Outlook

Further gains in industrial commodity prices are likely to be limited in the short term, due to the slowdown in global growth and ample stockpiles. The strength of the rand will also mute the impact of any commodity price increases on domestic inflationary pressures. However, with the increased likelihood of another round of quantitative easing in the US and continued growth in key commodity-consuming countries like China, there is a risk of price increases in the new year.

Weak demand, both locally and globally, low input costs as well as the strong rand will help to contain price increases of manufactured goods.

Implications

Favourable inflation statistics, the strong rand and the relatively weak growth outlook have strengthened the case for further easing in monetary policy. Past experience suggests that the Reserve Bank has been reluctant to cut rates at consecutive meetings towards the end of the cycle, opting rather to adopt a wait-and-see approach before deciding whether further easing is required. As a result, we expect the Reserve Bank's Monetary Policy Committee to pause over the next two meetings, with a possible 50 basis point cut in March next year. However, the continued improvement in the inflation outlook as well as the strength of the rand may prompt them to act sooner.

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