

Nedbank

Economic commentary

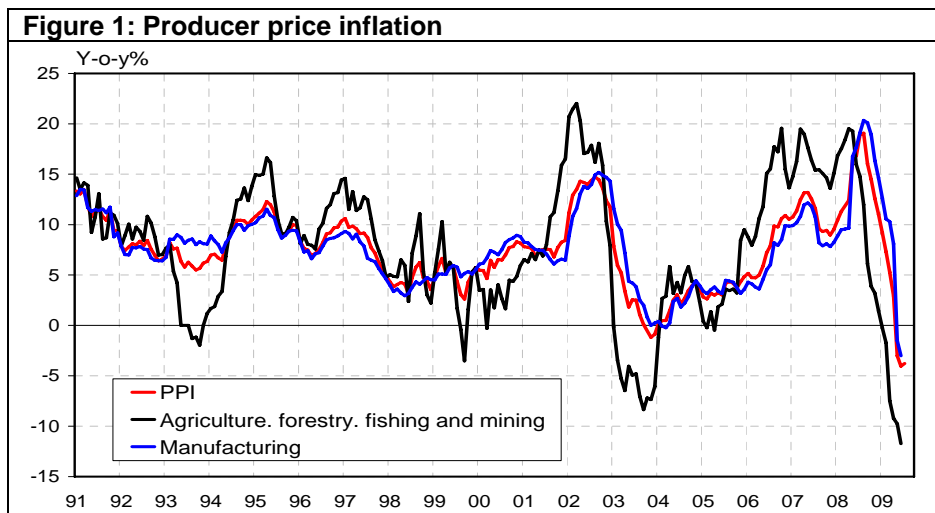
27 August 2009

PRODUCER INFLATION

Producer prices surprise on the upside on a monthly basis

Latest (July 2009)

Headline PPI: -3,8% y-o-y, 2,9% m-o-m (-4,1% y-o-y in June 2009)
Exported commodities: -9,3% y-o-y, -0,2% m-o-m (-9,7 y-o-y in June 2009)
Imported commodities: -17,5% y-o-y, 1,0% m-o-m (-17,9% y-o-y June 2009)



Source: Stats SA

Comment

Producer price figures for July came out higher than market expectations, but remained in negative territory. The 2,9% increase in PPI over the month was primarily due to the seasonal increase in electricity prices, up by 2,9% m-o-m following a 2,5% increase in June. This pushed the electricity prices up by 27,4% y-o-y from 23,1% in June.

Food prices at the agricultural level, which have been one of the main contributors to the downward trend in the overall producer prices, recorded an increase in July (up by 2,3% m-o-m) following five consecutive months of declines. All three major subcategories in this sector recorded price increases in July. The sharpest increase came from 'nursery & other agricultural products', where prices jumped by 5,7% following a 0,5% increase in June, while prices of 'food' and 'animal & animal' products rose by 2,3% and 1,2% respectively, following declines in the previous month. However, agricultural prices at the manufacturing level showed a modest decline over the month, falling by 0,1%, following a 0,8% decrease in June. On an annual basis, prices at the agricultural level decreased by 1,7% after falling by the same margin in June.

Volatility in commodity prices over the month kept prices in the mining and quarrying category steady on a monthly basis, but prices declined by 15,2% y-o-y. The annual decline was mainly due to decreases in the price of oil and metal ores, down by 26,6% and 22,7% respectively. The price of coal also recorded its first decline since May 2006, down by 0,4% in July.

Research

Group Economic Unit

Johannes Khosa
011 294 1835
JohannesKh@nedbank.co.za

Dennis Dykes
011 295 6435
Dennisd@nedbank.co.za

Outlook

Producer inflation should remain in negative territory over the next few months, helped by 2008's high base and weak global economic conditions. Annual producer price inflation may turn positive again towards the end of the year as base effects become less favourable. Our preliminary forecast for August is -3,7% y-o-y (up 0,6% m-o-m).

Implications

Today's producer inflation numbers were only slightly worse than our -4% y-o-y forecast and do not materially change our view that the inflation outlook is improving and that the Reserve Bank will probably have the scope it needs to cut rates one last time in this cycle (the consensus forecast was more optimistic, but this is a composite number that must have included some analysts who had forgotten about the electricity price hike). History suggests that there are often longer pauses near the bottom of the cycle, as indicators send conflicting signals. As a result, we anticipate that the Reserve Bank will hold off cutting rates in September. By October, the inflation outlook would have improved further, but growth prospects should still look extremely weak. One last cut of 50 basis points is therefore still possible, bringing the prime lending rate down to 10% before year-end.

Nedbank Head Office
NEDBANK GROUP ECONOMIC UNIT
135 Rivonia Road Sandown 2196
PO Box 1144 Johannesburg 2000
Tel +27 (0)11 295 6363
Email EstelleO@nedbank.co.za

Regular economic analysis is available on the Nedbank Group's internet site, <http://www.nedbankgroup.co.za>

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