Nedbank Economic commentary

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PRODUCER INFLATION

Research

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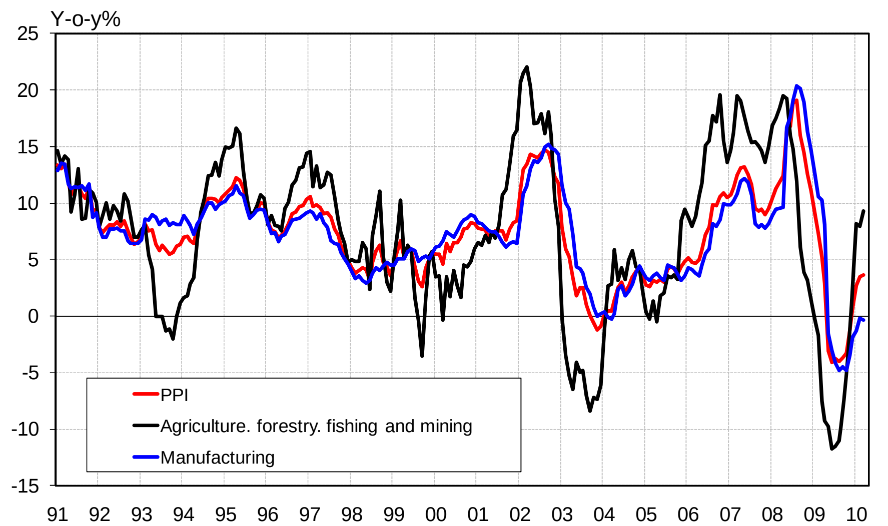
Producer inflation below expectations

- PPI came in slightly below market expectations
- Base effects and higher commodity prices, rather than demand-side pressures are behind the steady rise in producer inflation.
- Therefore our relatively favourable short-term inflation outlook remains unchanged,
- The strength of the rand combined with weak domestic demand, particularly for goods used in construction, will contain price increases
- Commodity price gains are expected to be muted and prices will probably settle in the second half of the year as global growth begins to slow.
- Today's PPI figure does not alter our view that interest rates will remain unchanged in May.

Latest (March 2010)

Headline PPI: 3,7% y-o-y, 0,3% m-o-m (3,5% y-o-y in February 2010)
Market forecast: 3,9% y-o-y
Nedbank forecast: 3,9% y-o-y

Figure 1: Producer price inflation



Source: Stats SA

Comment

Producer price inflation picked up slightly in March, increasing to 3,7% y-o-y, up from 3,5% y-o-y in February. This was slightly below market expectations.

Agricultural prices continued to decline, falling by 0,4% m-o-m, due to declines in grain and vegetable prices. In contrast, food prices at the manufacturing level rose modestly, up by 0,2% m-o-m. Both categories continued to decline on an annual basis, falling by

3,2% and 1,5% respectively.

The steady increase in commodity prices over the past few months continued to put upward pressure on producer inflation, with the mining and quarrying category rising by 14,8% y-o-y, contributing 2,8% to the annual increase. Over the month, petroleum and related products recorded the largest gains, increasing by 1,3%.

Inflationary pressures in most other categories remained extremely muted. The manufacturing category continued to experience deflation, with prices falling by 0,3% y-o-y, due to lower prices for food, wood, chemicals and rubber, base metals, radios and televisions compared with this time last year.

Outlook

Producer inflation will rise sharply in the next few months. However, this will largely be the result of the low base established in the first half of 2009, rather than demand-pull inflationary pressures.

The strength of the rand combined with weak domestic demand, particularly for goods used in construction, will contain price increases for beneficiated metals, machinery, chemicals and other related products.

Commodity price increases are expected to remain muted.

Lower agricultural prices will continue to put downward pressure on producer inflation. Both international and local agricultural prices have declined since the start of the year, led by lower grain prices. Grain prices have fallen, following bumper harvests and falling demand from the livestock sector.

Oil prices remained relatively steady in the first three months of the year, constrained by high US oil inventories and no further production cuts by OPEC. More recently oil has broken through the $80 a barrel level and seems to be setting a new, higher trading range, as global oil demand continues to recover. However, the Centre for Global Energy Studies recently commented that there was limited scope for upward pressure on prices due to ample spare production capacity within OPEC as well as an increase in global refining capacity.

The slower pace of inventory accumulation in China has put a damper on certain industrial metal prices, although new pricing arrangements for iron ore could push global steel prices up over the medium term. Commodity prices will probably settle in the second half of the year as global growth begins to slow.

Implications

Today’s PPI figure does not alter our view that interest rates will remain unchanged in May, following Governor Marcus’ comments last week which largely ruled out a cut at the next meeting. However, the fragile nature of the recovery leaves the door open for a further reduction in interest rates.

	Headline PPI							
		March 2010					March 2009	
	Weights	Month-on-month		Year-on-year		Ave m-o-m	M-o-m %	Y-o-y %
	Base 2000	%	% contrib	%	% contrib	past 3 yrs		
Total	**100.0**	**0.3**	**0.3**	**3.7**	**0.00**	**0.8**	**0.4**	**3.5**
Agriculture. forestry. fishing and mining	29.4	0.3	0.09	9.3	2.73	1.5	0.4	7.9
Agriculture	8.2	-0.4	-0.03	-3.2	-0.26	0.0	-1.9	-6.4
Food	3.9	-1.3	-0.05	-8.2	-0.32	-0.9	-4.2	-13.5
Grain	0.9	-1.8	-0.02	-19.1	-0.17	1.2	-4.0	-16.7
Vegetables	1.1	-3.1	-0.03	-9.6	-0.11	-0.7	-12.9	-12.0
Fruits & nuts	1.4	-0.2	0.00	-6.1	-0.09	-2.6	-0.4	-19.9
Oil seeds	0.1	-1.1	0.00	4.5	0.01	-1.1	4.7	1.8
Sugar cane	0.3	0.0	0.00	15.6	0.05	0.6	1.7	17.7
Other food	0.0	2.4	0.00	8.0	0.00	1.6	3.2	8.1
Live animals & animal products	3.7	0.7	0.02	2.8	0.10	1.1	0.8	2.3
Nursery products & other agriculture	0.7	-0.2	0.00	-1.7	-0.01	0.4	-1.7	-2.8
Forestry	1.5	0.5	0.01	8.7	0.13	-0.1	6.8	7.3
Fishing	0.3	0.5	0.00	-2.0	-0.01	0.8	1.3	-0.9
Mining & quarrying	19.4	0.6	0.11	14.6	2.84	2.3	0.9	14.2
Coal & lignite	5.0	0.1	0.01	15.5	0.77	1.4	0.9	15.5
Crude petroleum & natural gas	0.6	1.3	0.01	11.0	0.07		0.3	9.9
Metal ores	11.5	0.9	0.10	17.7	2.03	2.9	0.8	17.2
Other minerals	2.3	-0.1	0.00	-6.9	-0.16	0.9	1.3	-7.8
Manufacturing	62.3	0.4	0.27	-0.3	-0.20	0.6	0.2	-0.2
Food at manufacturing level	5.9	0.2	0.01	-1.5	-0.09	0.8	0.1	-1.2
Beverages	3.0	1.6	0.05	3.6	0.11	1.0	-0.1	2.7
Tobacco products	0.6	0.0	0.00	13.8	0.08	0.0	0.0	13.8
Textiles & made-up goods	1.1	0.7	0.01	2.0	0.02	1.3	0.0	3.2
Wearing apparel	1.5	-0.5	-0.01	0.5	0.01	-0.2	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	0.7	0.00	3.0	0.01	0.5	-0.5	3.2
Wood & wood products	1.4	0.0	0.00	-2.1	-0.03	0.1	-1.1	-2.1
Paper & paper products	5.0	0.1	0.00	1.5	0.07	-0.1	0.4	1.2
Products of petroleum & coal	5.0	0.8	0.04	9.0	0.45	3.0	2.0	12.8
Chemicals & chemical products	6.7	0.1	0.00	-5.6	-0.38	0.1	0.1	-5.6
Rubber & plastic products	2.6	0.3	0.01	-2.6	-0.07	0.4	-0.1	-2.4
Non-metallic mineral products	2.0	0.2	0.00	5.5	0.11	0.2	1.5	5.4
Basic metals	6.7	0.2	0.01	-7.2	-0.48	0.0	-0.9	-8.1
Metal products	3.3	-0.3	-0.01	3.9	0.13	0.0	0.5	3.9
Non-electrical machinery & equipment	2.4	0.1	0.00	1.9	0.04	0.0	1.6	1.8
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	0.0	0.00	2.2	0.04	0.0	0.2	2.0
Radio. TV & communication equipment	0.5	0.0	0.00	-0.3	0.00	-0.2	0.3	-1.4
Medical appliances. instruments & clocks	0.3	0.0	0.00	1.8	0.01	0.0	0.0	1.8
Transport	5.8	0.0	0.00	0.7	0.04	0.0	-0.1	0.6
Furniture	1.0	0.2	0.00	3.1	0.03	0.2	-0.1	3.2
Other manufactures	5.0	4.9	0.24	-1.3	-0.07	3.7	0.4	-0.1
Electricity, gas and water	8.3	-0.9	-0.07	15.1	1.26	-0.8	1.4	16.2

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