Nedbank
Economic commentary

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CONSUMER INFLATION

Research

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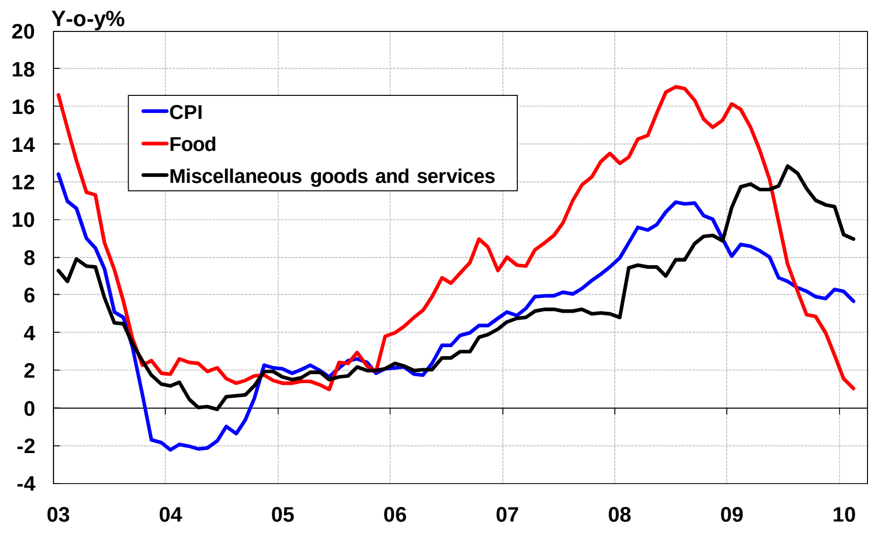
CPI falls below 6%

- Inflation in line with market expectations
- Some upward pressure came from services inflation
- Demand-pull inflation is expected to remain dormant during 2010
- We expect interest rates to remain unchanged until Q3 2011

Latest (February 2010)

Overall: 5,7% y-o-y, 0,6% m-o-m (6,2% y-o-y in January 2010)
Nedbank forecast: 5,5% y-o-y
Market forecast: 5,7% y-o-y

Graph 1: Consumer price inflation



Comment

Consumer inflation is back within the target range and is expected to remain below 6% for the rest of 2010.

The main driver of inflation remains the services sector. Insurance costs rose by 6,3% over the month, taking the annual increase to 11,5%. Medical services also rose sharply last month, increasing by 8,1%, although its overall weight in the basket is very small. Higher petrol prices also contributed towards the monthly increase in inflation, rising by 2,4% m-o-m. Since January 2009, petrol prices have risen by 22% y-o-y.

Food prices fell by 0,6% m-o-m and rose by a modest 1% over the past year. All categories declined over the month, except sugars and sweets which remained unchanged. The largest monthly declines were recorded in the fruit and vegetable categories.

Weak household demand, combined with the strength of the rand, continued to put downward pressure on prices of durable and semi-durable goods. Prices of furniture and appliances fell by 3,4% y-o-y and 1,2% y-o-y respectively. Telecommunication equipment declined by 1,6% m-o-m and 22% y-o-y.

Outlook

Figure: SAFEX agricultural prices

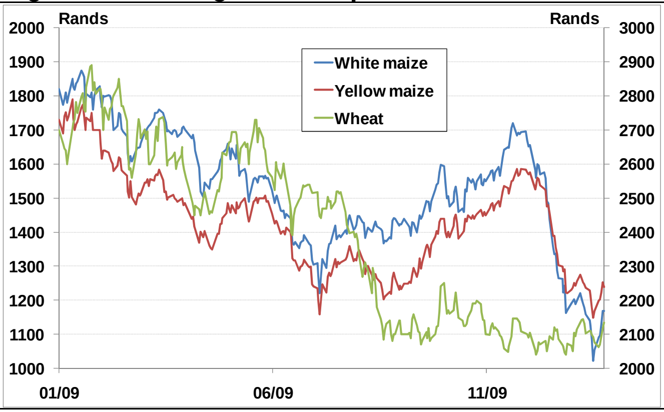


Figure: Economist food price index

Inflation will remain below the target band during the remainder of 2010, reaching its trough in May. Thereafter, inflation is expected to pick up during the rest of 2010.

Food prices will continue to put downward pressure on 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. Inflationary pressures at the producer level also remain dormant, with prices declining on an annual basis.

The strength of the rand combined with weak domestic demand will continue to put downward pressure on durable and semi-durable goods inflation. Discounting, needed to entice price-sensitive consumers into the shops, will also help to put downward pressure on prices. Services inflation, which is backward looking, should moderate further as companies set prices based on last year's average inflation of 7,3%, which was a marked improvement from 2008's double-digit inflation used to calculate 2009 price increases.

Upward pressure on inflation will come from Eskom's 25% tariff increase, which is due to take effect in July. The 2010 FIFA Soccer World Cup could also turn out to put some upward pressure on prices, as companies in the hotel, restaurant, general entertainment and travel industry look to take advantage of the influx of tourists into the country.

Implication

The Monetary Policy Committee faces an interesting decision on Thursday. Although inflation is back in the target range, this was fully anticipated by both the market and the MPC and should not in itself lead to a change in stance. Instead the MPC should be focusing on 2011, where the inflation outlook is a bit murkier, with a strong possibility that the upper end of the target range could be breached once again. The recent turnaround in economic indicators such as gdp and retail sales could also mitigate against a further cut. However, the committee could be tempted to cut given that the recovery remains relatively fragile, with fixed investment spending still contracting and credit demand showing few signs of reviving. The dip in inflation to below 6% could give added comfort as would the recent stressing of the flexibility of the Reserve Bank's mandate by the finance minister. We think that the decision will be a close call (55:45), but that the MPC will probably opt to keep rates unchanged into 2011.

	CPI							
		February 2010					January 2010	
	Weights	Month-on-month		Year-on-year	Average	Average	Month	Year
		%	%	%	m-o-m	y-o-y	%	%
	Base 2008		contrib		past 3 yrs	past 3 yrs		
CPI for all urban areas	100	0.6	0.6	5.7	0.8	7.69	0.3	6.2
Food and non-alcoholic beverages	**15.68**	**-0.4**	-0.1	**1.8**	**0.0**	**10.10**	**0.7**	**2.4**
Food	14.27	-0.6	-0.1	1.0	-0.2		0.8	1.6
Bread and cereals	3.08	-0.3	0.0	-2.9	0.8	13.54	0.0	-2.9
Meat	4.59	-0.7	0.0	0.2	-0.5	5.73	1.0	1.3
Fish	0.66	-0.2	0.0	4.1	-0.1	9.99	0.9	4.5
Milk, eggs and cheese	1.79	-0.3	0.0	6.9	0.2	14.05	0.4	7.2
Oils and fats	0.53	-0.3	0.0	-13.3	0.0	15.21	-0.8	-14.6
Fruit	0.47	-3.2	0.0	8.1	-2.2	9.03	4.7	10.9
Vegetables	1.63	-1.6	0.0	-0.6	-1.1	13.23	0.9	0.3
Sugar, sweets and deserts	0.77	0.0	0.0	7.1	0.2	9.29	0.6	7.4
Other	0.75	-0.3	0.0	7.2	0.1	12.02	1.7	8.1
Non-alcoholic beverages	1.41	2.1	0.0	10.1	1.8	11.12	0.9	11.1
Alcoholic beverages and tobacco	**5.58**	**0.0**	0.0	**10.1**	**0.8**	**9.50**	**0.2**	**11.3**
Alcoholic beverages	3.29	0.1	0.0	6.7	1.0	7.12	0.3	7.5
Tobacco	2.29	-0.1	0.0	14.9	0.4	12.82	0.1	16.5
Clothing and footwear	**4.11**	**0.0**	0.0	**3.1**	**0.3**	**5.55**	**0.1**	**4.0**
Clothing	2.9	0.0	0.0	3.2	0.4	5.58	0.2	4.2
Footwear	1.21	0.2	0.0	3.1	0.2	5.43	0.1	3.3
Housing and utilities	**22.56**	**0.0**	0.0	**7.0**	**0.0**	**9.03**	**0.1**	**7.0**
Actual rentals for housing	3.49	0.0	0.0	4.9	0.0	6.67	0.0	4.9
Owners equivalent rent	12.21	0.0	0.0	4.3	0.0	1.42	0.0	4.3
Maintenance and repairs	1.68	0.2	0.0	4.9	0.3	10.26	0.4	5.4
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	24.1	-0.1	20.90	0.0	23.9
Household contents and equipment	**5.86**	**-0.2**	0.0	**1.6**	**0.1**	**4.17**	**0.0**	**2.6**
Furnishings, floor coverings and textile	2.17	-0.5	0.0	-3.4	-0.2	-1.76	0.0	-2.4
Appliances, tableware and equipment	1.05	-0.8	0.0	-1.2	0.2	4.82	0.5	2.1
Supplies and services	2.64	0.2	0.0	6.7	0.2	7.84	-0.2	6.9
Domestic workers wages	1.99	0.0	0.0	6.2	0.0	7.28	0.0	6.2
Health	**1.47**	**5.0**	0.1	**9.0**	**5.3**	**9.19**	**0.0**	**10.3**
Transport	**18.8**	**0.7**	0.1	**5.1**	**1.0**	**4.77**	**-0.4**	**6.2**
Purchase of vehicles	11.25	0.4	0.0	1.5	0.3	0.45	-0.4	1.7
Private transport operation	4.82	1.8	0.1	18.5	3.9	11.01	-0.5	25.6
Petrol	3.93	2.4	0.1	22.1	5.1	12.99	-1.0	31.7
Other running costs	0.89	0.4	0.0	8.2	0.5	9.68	0.8	8.9
Public Transport	2.73	0.1	0.0	1.2	0.0	6.38	-0.4	0.5
Communication	**3.22**	**-0.1**	0.0	**-0.1**	**-0.1**	**0.22**	**-0.1**	**-0.1**
Recreation and culture	**4.19**	**-0.8**	0.0	**6.2**	**0.0**	**5.28**	**0.1**	**8.1**
Education	**2.19**	**0.0**	0.0	**10.5**	**0.0**	**8.02**	**0.0**	**10.5**
Restaurants and hotels	**2.78**	**0.5**	0.0	**7.9**			**1.1**	**8.4**
Miscellaneous goods and services	**13.56**	**3.5**	0.5	**8.9**	**3.3**	**9.37**	**1.4**	**9.2**
Personal Care	2.20	-0.2	0.0	6.6	0.6	8.48	0.8	8.4
Insurance	7.71	6.3	0.5	11.5	5.7	9.34	0.9	11.6
Financial Services	1.27	0.0	0.0	7.0	0.0	10.61	3.1	7.0
Other Services	2.38	0.0	0.0	4.0	0.0	8.74	2.7	4.0

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