

## CONSUMER AND RETAIL BAROMETER

### Some mild inflation relief for the poor in 2017???

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While economic times would likely remain challenging, good news for lower income groups in 2017 would be an alleviation of drought conditions and a meaningful slowing in food price inflation.

The impact of the recent drought conditions has had a severe impact on Agriculture production and likely on employment too. But it goes far beyond that, extending to its impact on food prices and thus overall consumer price inflation. That can have implications for interest rates as well as national real disposable income growth. But it is arguably the greater impact that high food price inflation has on the poor that makes it most crucial that drought conditions are hopefully alleviated in 2017.

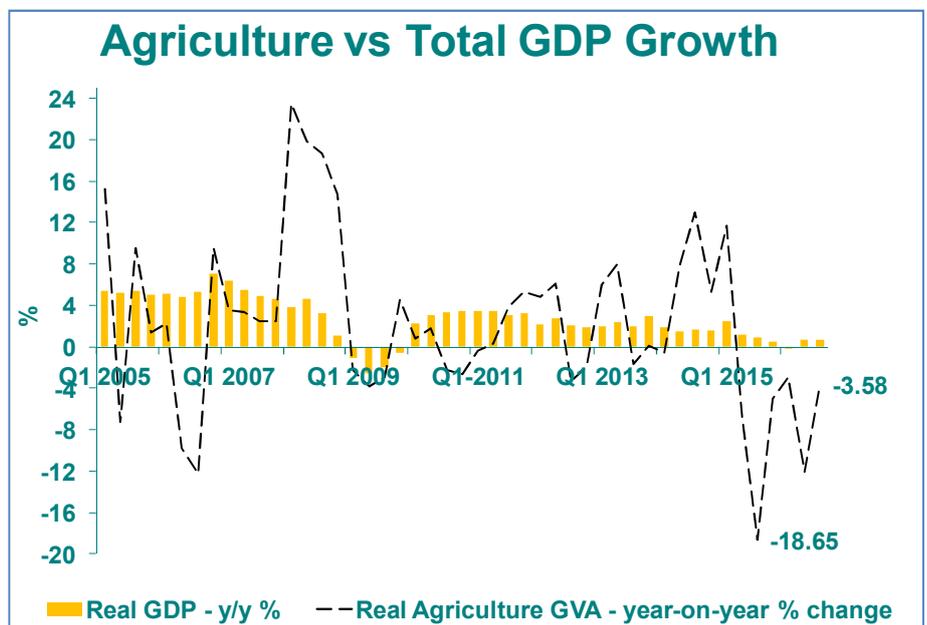
An end to drought conditions in 2017 would have a significantly greater impact on the poor than on the higher income groups in South Africa.

#### THE RECENT DROUGHT HAS HAD A SEVERE IMPACT ON AGRICULTURE OUTPUT

The drought has been inflicting severe pain on the Agriculture Sector, which would spill over into sectors supplying inputs to that sector, and has such has had a directly negative impact on the overall economy of South Africa.

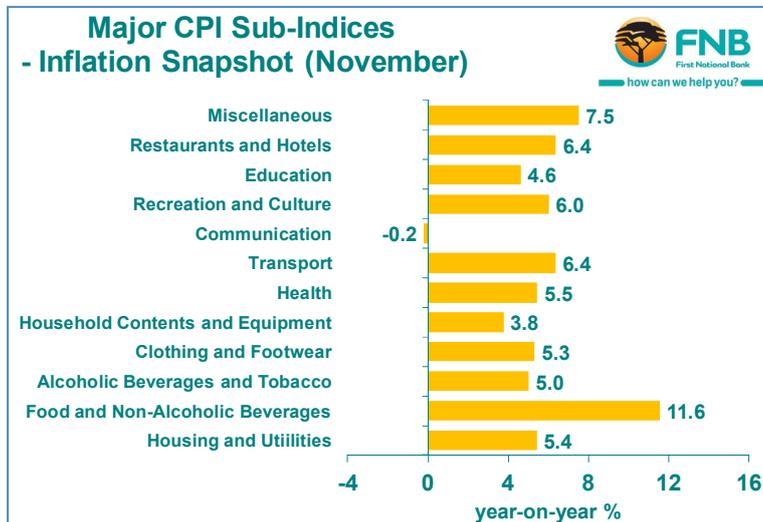
Agriculture GVA (Gross Value Added) growth dropped sharply into negative territory back in 2015, dipping as low as a -18.65% year-on-year decline as at the 3<sup>rd</sup> quarter of 2015, before becoming “less negative” to reach a -3.58% year-on-year decline in the 3<sup>rd</sup> quarter of 2016.

This drop has had an impact on overall economic growth, although the country is fortunate that the Agriculture Sector only makes up about 2-3% of the total economy these days. Nevertheless, it is an important 2-3%, and does account for a larger 5.6% of total employment in South Africa.



## BUT PERHAPS IT IS IN THE AREA OF CONSUMER PRICES WHERE THE IMPACT OF THE DROUGHT IS MOST FELT

But, while Agriculture's recent weakness has had some negative impact on the overall economy's growth rate as well as on employment, it is arguably in the area of consumer prices where its impact is felt most, and why an end to the severe drought in 2017 would be most welcome. The drought's impact on food supply has been a key driver of sharply higher food price inflation in recent times, and this has had implications for the consumer.



The Food and Non-Alcoholic Beverages component of the Consumer Price Index (CPI) for South Africa has a large weighting of 15.4% of the overall CPI. It thus has the ability to significantly influence the overall CPI inflation rate. As at November 2016, the Food and Non-Alcoholic Beverages CPI inflation rate accounted for 1.8 of a percentage point of the overall CPI inflation rate of 6.6% in that month, making it the largest single contributor to the overall CPI inflation rate.

The contribution was so large due to the Food and Non-Alcoholic Beverages CPI having by far the highest year-on-year inflation rate of the major CPI components, to the tune of 11.6%, as

well as this component of the CPI having a large weighting.

A hypothetical lower food inflation rate could thus have meant that the CPI inflation rate could have been within the SARB's 3-6% target range in recent times, and this may or may not have had interest rate implications. It is impossible to know whether interest rates today would have been a little lower than they are, should there have been no drought, but it is conceivable given the SARB's inflation targeting focus.

But it goes further than merely being able to influence interest rates. Higher consumer price inflation eats into nominal disposable income to a greater extent, and can thus have a dampening effect on disposable income growth in real terms, something that has been the case through 2016 given consumer inflation's resurgence from a significantly lower rate in 2015.

## THE POOR BORE THE BRUNT OF HIGH FOOD PRICE INFLATION FAR MORE THAN THE AFFLUENT IN 2016

But the importance of the drought ending, and food price inflation hopefully falling in 2017, goes even further than that.

The CPI inflation rates as broken down into "expenditure quintiles", are often overlooked. With the key focus of many analysts on where interest rates are headed, the Headline CPI inflation number is all important to them given the SARB's (South African Reserve Bank) 3-6% inflation target.

Consumer price inflation, however, has far more importance than merely its impact on interest rates, and can provide valuable insights into where "pressure points" are building in the economy.

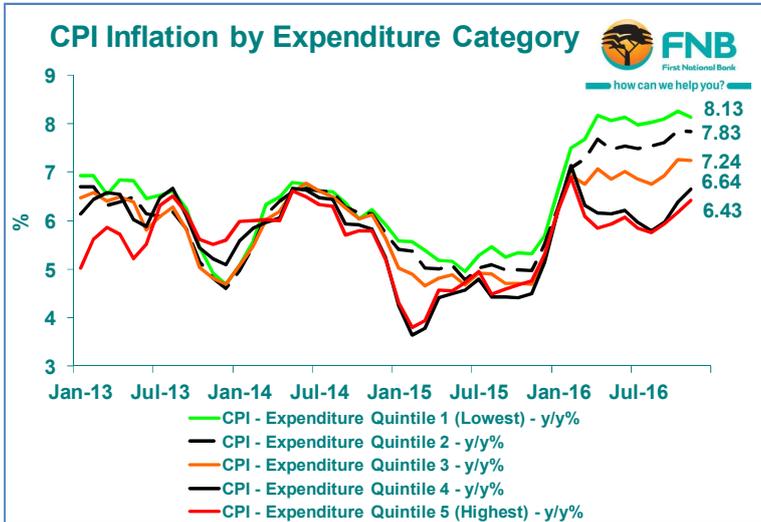
The fact that the CPI inflation rate rose from 4.6% in 2015 to 6.3% in 2016 (average for the 1<sup>st</sup> 11 months of the year) was troublesome. But even more troublesome than this, however, was that food price inflation was a key driver, and thus caused the lower income groups to have a significantly higher CPI inflation rate than the more affluent groups.

Breaking up the CPI into 5 CPI's according to expenditure quintile, one sees that 2015 was something of an "annus horribilis" for the lower income groups. The CPI's per expenditure quintiles are defined as follows:

Quintile 1 – Households with annual expenditure up to R 21 399;

Quintile 2 - Households with annual expenditure R 21 400 up to R 35 750;

Quintile 3 - Households with annual expenditure R 35 751 up to R 61 624;  
 Quintile 4 - Households with annual expenditure R 61 625 up to R 142 083; and  
 Quintile 5 - Households with annual expenditure R 142 084 and more.



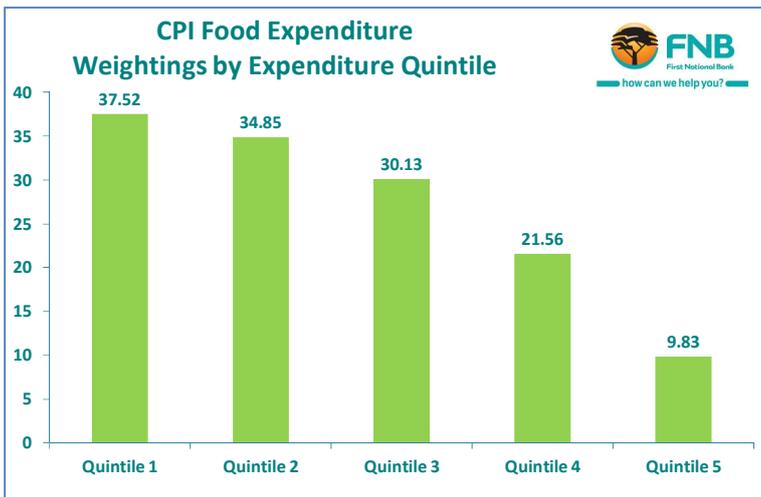
The expenditure quintiles are a good proxy for income groups, and what happened in 2016 was the opening up of a wide gap between the lower quintiles' CPI inflation rates and those of the higher expenditure groups (i.e. the more affluent)

As at November 2016, Quintile 1, the lowest expenditure group, experienced a CPI inflation rate of 8.13% year-on-year. By comparison, Quintile 5, the highest expenditure group, experienced a significantly lower inflation rate of 6.43%, the other quintiles' inflation rates somewhere in between.

Key to this differential between lower and higher expenditure quintiles was food price inflation, because the lower income/expenditure groups spend a far greater portion of their income on food.

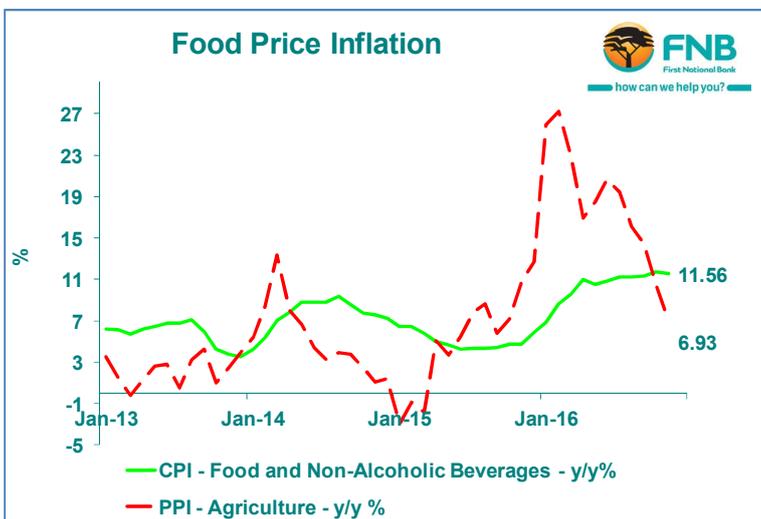
Quintile 1's CPI has a food weighting of 37.52%, while Quintile 5 has a lowly 9.83% food weighting. The other quintiles fall in between these 2 outer extremes.

So, when food price inflation does what it did in 2016, it has a far greater impact on the poor. This is a key concern, not only due to the poor having less financial buffers with which to weather economic and financial "storms", but also due to the country's currently "elevated"



level of social tensions, which can lead to political and economic instability should they deteriorate. And a key source of financial pressure on the poor such as a food price inflation surge can pose a threat in this regard.

**EARLY ENCOURAGING SIGNS FOR LOWER FOOD PRICE INFLATION IN 2017**



Certainly, one cannot yet say that the drought has ended, with many parts of the country still suffering heavily. But there have been some encouraging reports in certain parts, and a sharp slowdown in the Producer Price Index for Agriculture, from 20.6% year-on-year in June 2016 to 6.9% by November 2016 provides some hope that the CPI for Food and Non-Alcoholic Beverages will soon begin to see an inflation slowdown (The PPI for Food normally leading the CPI Food trends).

This is expected to be key in slowing overall CPI inflation back into the 3-6% target range, from an expected average of 6.3% for 2016 as a whole to 5.9% in 2017. This slowing in overall CPI inflation is not a major one, but is important in terms of our expectation that 2017 may not see further interest rate hiking.

Arguably far more important, however, is that we would expect to see a more significant slowing in the CPI's of the lower expenditure quintiles, and a narrowing of the gap between the inflation rates of the lower quintiles and the high expenditure quintiles.

## **CONCLUSION**

**Long term weather forecasting has proved very difficult, and drought conditions are far from over. But the hopeful end, or at least alleviation, of drought conditions in 2017 will be crucial to economic stability for reasons far beyond their direct impact on Agriculture production. Low income groups will likely still have challenges stemming from weak employment creation in 2017. But a noticeable drop in food price inflation IN 2017 would be some good news for them, given the far greater portion of their income that they must spend on food compared to higher income groups..**