EFFICIENT GROUP

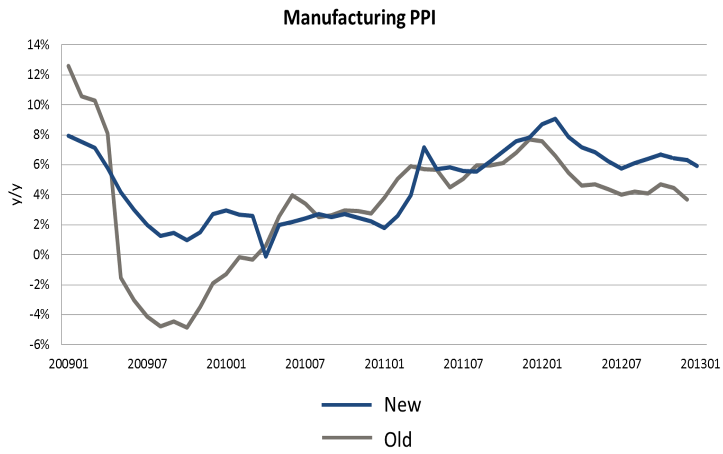
Economics

This might be the last chance

Statistics South Africa (Stats SA) released their totally redone Producer Price Index (PPI) this week. This much more comprehensive and better PPI indicated that inflation of final manufactured goods (now the new headline PPI) increased 5.8% y/y in January. This comes after Decembers' lower increase of only 5.2% y/y (calculated with the old index), albeit not directly comparable. The main contributors to this month's annual increase were food products, beverages and tobacco products (6.5% and contributing 2.2 percentage points), and coke, petroleum, chemical, rubber and plastic products (7.8% and contributing 1.3 percentage points). Main contributors on the monthly increase of 0.5% were transport equipment (1.6% and contributing 0.2 of a percentage point) and metals, machinery, equipment and computing equipment (1.0% and contributing 0.2 of a percentage point).

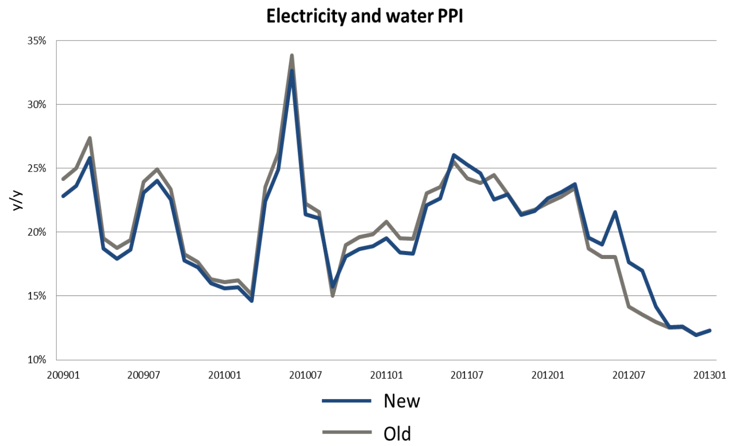
The new reporting methodology of PPI means that Stats SA now provides five distinct PPI's, namely for agriculture, mining, electricity and water, manufacturing for intermediate goods and manufacturing for final goods. It is nevertheless interesting to compare the previous and new indices with each other. The graphs below display the reweighted previous indices versus the new.

Figure 1



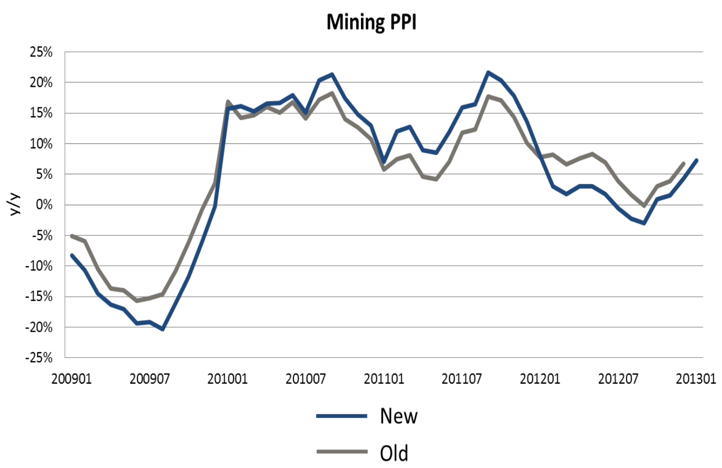
Notice how in figure 1, the newly restructured PPI is tracking much higher than the old PPI. The trend is still downward, but the pace of slowdown is very moderate.

Figure 2



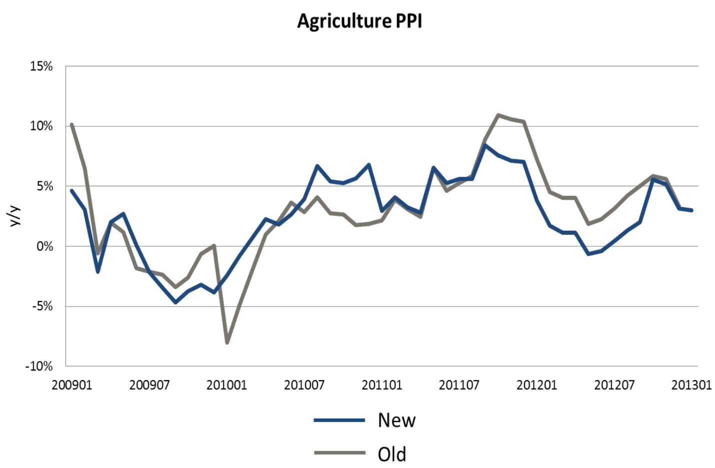
For the PPI of electricity and water (figure 2), the gap between old and new closed during January after about nine months of underestimated PPI.

Figure 3



The mining PPI index indicates over estimation of PPI for most of last year.

Figure 4



Agriculture PPI also shows a narrowing between the two indices by January after about 18 months of overestimated PPI in this sector.

Continued

Despite the new headline PPI index tracking slightly higher than the old PPI index, the rise in PPI has moderated somewhat since the beginning of 2012. We anticipate this new PPI structure to correlate better with the consumer price inflation (CPI) movements in the months to come. This index is also expected to be more stable and more reflective of the actual production cost within each industry. This will provide more directional emphasis when utilising both these indices for interest rate decision purposes.

We forecast slightly weaker CPI growth for 2013 averaging 5.6% y/y while PPI is expected to average 6.0% y/y during 2013. These (albeit marginally) lower estimates could provide the last chance for the Reserve Bank to adjust the repo rate lower during the second half of 2013 if the local economy struggles to reach the 2.8% growth forecast due to further deterioration in global economic growth projections. We will revise our view on interest rates as this year's inflation story unfolds.

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