EFFICIENT GROUP

ECONOMIC COMMENTARY

- Dr. Francois Stofberg

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WHAT TO EXPECT FROM FUEL PRICES IN SOUTH AFRICA

As the war in the Ukraine continues, you might have heard some rumours about fuel prices in South Africa (SA). Some commentators that I would not refer to as experts even believe that fuel prices can reach R40 a litre. Although nothing is impossible, I doubt this has much more than a 10% probability of occurring. Our own estimates show that an extreme case will see prices reach R30. So, I thought I would demystify some of the rumours and falsehoods about fuel prices, and their impact on consumer prices and household budgets.

Before the last fuel price increase in SA, oil prices were trading around $105 a barrel. In our view, oil prices can reach $200 a barrel, although an upper limit around $185 is more probable. The simple fact is that the world cannot completely boycott Russian oil and gas. At least not overnight. At these extreme levels, and considering the stickiness of oil prices, every company and country will be motivated to produce oil. I would not be surprised if some countries that have been struggling with internal conflicts, like Venezuela, would declare a ceasefire in the interim simply to produce more oil and to make boatloads of money. Also, Russia still has many 'allies', even though they are at arm's length now. Should oil prices skyrocket globally, these 'allies' would be happy to buy Russian oil over the counter at much lower prices. Something that we would never hear about. The rand has also been strong and should remain so in 2022. I doubt that we will see an average rate higher than R15.50, but even R14.50 is likely. But let us assume that oil prices go up to $185 (from the $105-level it was trading before the last fuel price increase) and the rand depreciates to R15.50 (from R15.00), this would imply that the cost per barrel in SA would increase with 80%.

But herein lies the catch. We currently pay R21.35 for unleaded 93 petrol inland in SA, but only R10.90 (51% of the total price) is oil related. The remaining 49% of the price is taxes and costs that go to producers and distributors in SA. So, even if prices increase 80%, consumers will only feel 51% of that 80% price increase (40.41%), meaning that fuel prices will most likely, in a worst-case scenario, only go up to around R30 a litre. What does this mean for household budgets? According to Statistics South Africa (Stats SA), the average household earns R48 000 and spends 4.82% on fuel, which is now 40.41% more expensive. The average household will, therefore, pay about R935 more for fuel each month. Put differently, the Consumer Price Index (CPI) will increase from an average 2022 estimate of 4.5% to 6.45%.

Now, for the indirect impact of fuel prices. It is somewhat true that if fuel prices increase, 'everything' becomes more expensive. But too many South Africans believe that everything becomes unbearably expensive. My barber is probably not going to charge me more because fuel prices have increased, neither will my gym fees increase. My insurance, bond (or the rent that I pay), or car repayments are not increasing. These items constitute a much larger share of household expenses than food prices, which everyone is concerned about. If you want a more accurate estimate of the indirect impact of higher fuel prices, it is better to consider the share of 'petroleum products' as inputs among producers. According to Stats SA, this share is 8.8%. So, if fuel prices are increasing by 40.41%, producer prices can increase between 3.56% and 12.36%. Fortunately for consumers, and considering historic price increase differences between consumers and producers, producers will, at most, only be able to pass on about 25% of this increase, although it might be a lot lower. In doing so, producers might add another 1.71% to the CPI. On a technical note, I have assumed that we will only have a second-round price impact because after this the impact will be marginal.

In total, including direct and indirect impacts of a worst-case scenario, where oil prices increase to $185 a barrel for a prolonged period, and the rand depreciates to R15.50, consumer prices in SA might increase from the expected 4.5% to 7.51%. In the context of SA's high historic inflation rates, 7.51% does not really warrant all the hysteria that we currently see in the media.

81 Dely Road, Hazelwood, Pretoria, 0081 | +27 (0)87 944 7999 | info@efgroup.co.za | www.efgroup.co.za