OXFORD ECONOMICS AFRICA

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Talking Point | South Africa

Inflation cools more than expected in May

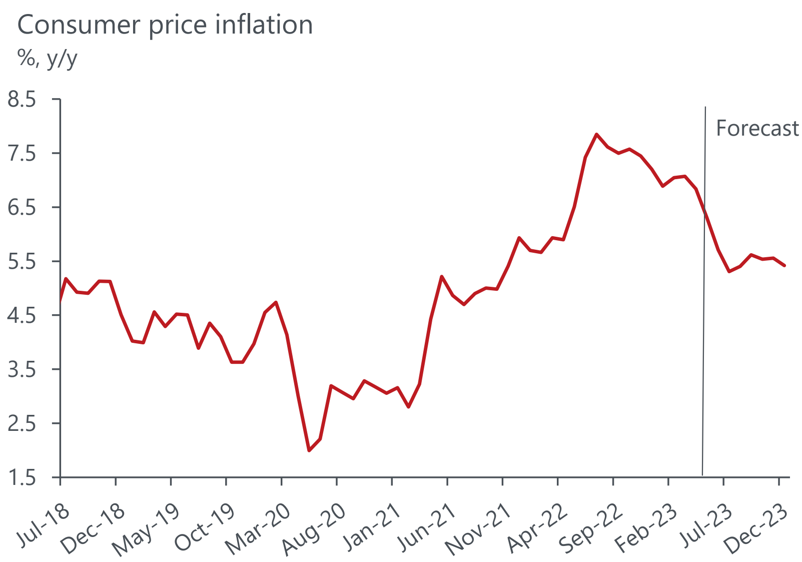
- **The 6.3% y/y inflation print marks the lowest reading since May 2022 and supports our view that CPI inflation will return to the South African Reserve Bank's (Sarb) inflation target band by the end of H1 2023. Food price inflation eased further from peak levels but will remain elevated over the coming months.**

Headline inflation decelerated in May to reach 6.3% y/y, down from the 6.8% y/y recorded during the previous month. This outcome was again lower than both our expectation and the consensus forecast of 6.5% y/y. The CPI increased by 0.2% m/m in May versus the 0.4% m/m increase in April.

The main contributors to the annual inflation rate were food & non-alcoholic beverages (+11.8% and contributing 2.1 ppts), housing & utilities (+4.0% and contributing 1.0 ppt), transport (+7.0% and contributing 1.0 ppt), and miscellaneous goods & services (+6.3% and contributing 0.9 ppt). Although food price inflation has indeed peaked, prices will remain elevated over the coming months as consumers contend with high living costs across the board.

Core inflation (which excludes volatile items such as food, non-alcoholic beverages, fuel, and energy) eased slightly to 5.2% y/y in May. The latest data also shows that goods inflation dropped to 8.0% y/y in May (previously: 9.0% y/y), while annual services inflation was unchanged at 4.7%.

Chart 1: Headline inflation slowed to 6.3%y/y in May, with more disinflation expected over the coming two months

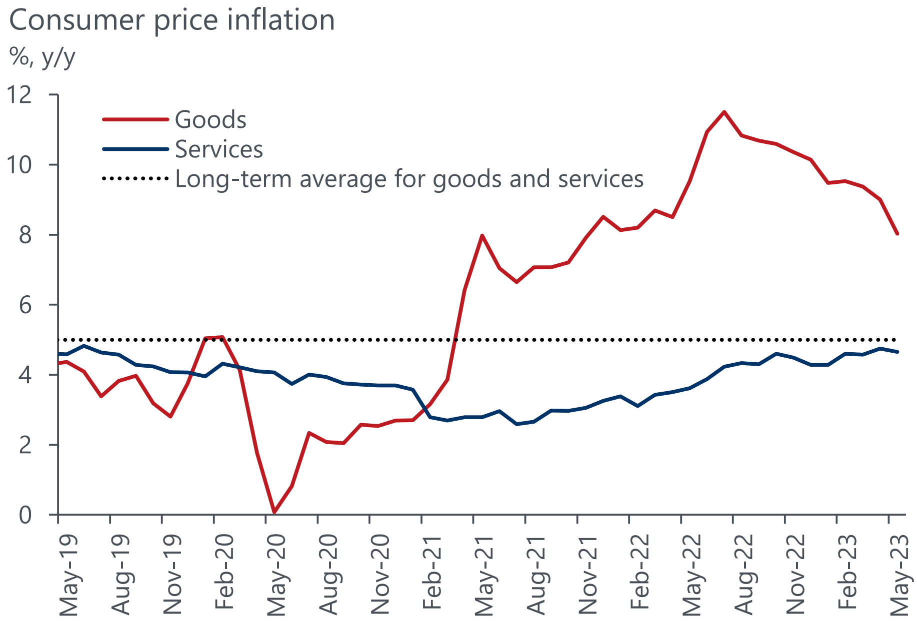


Source: Oxford Economics Africa

WHY DO WE CARE? *The favourable inflation outcome for May means that South Africa's real interest rate is calculated at roughly 2.0% and is back at pre-pandemic levels. Our base case remains for inflation to average 6.1% in 2023, as we anticipate favourable base effects to dissipate from August onwards. What's more, the impact of a weak rand exchange rate, relatively high fuel prices together with power outages are keeping costs elevated for businesses in general. With previous rate increases yet to fully filter through to the real economy and CPI inflation forecast to return to the Sarb's inflation target band by the end of H1 2023, in conjunction with the weak growth environment, additional interest rate increases could be too restrictive. Although further tightening will not boost the rand, our base case is for a further 25-bps rate increase in Q3, pushing the repo rate to 8.5%.*

Jee-A van der Linde - Senior Economist - javanderlinde@oxfordeconomics.com

Chart 2: Goods inflation has yet to return to its long-run average of 5.0%, while services inflation remains below that level



Source: StatsSA

Table 1: Aside from the clothing & footwear price sub-index, price pressures were broadly lower in May

Major CPI sub-indices (y/y)				
	Mar-2023	**Apr-2023**	**May-2023**	**Δppts**
Overall CPI	**7.1%**	**6.8%**	**6.3%**	**-0.50**
Food & non-alcoholic beverages	14.0%	13.9%	11.8%	-2.1
Alcoholic beverages & tobacco	6.2%	6.4%	5.9%	-0.5
Clothing & footwear	2.9%	3.0%	3.2%	0.2
Housing & utilities	4.0%	4.1%	4.0%	-0.1
Transport	8.9%	7.6%	7.0%	-0.6
Communication	0.0%	0.2%	-0.2%	-0.4
Miscellaneous goods & services	5.9%	6.3%	6.3%	0.0

Source: StatsSA