Inflation on the way down

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The New Year started on a good note for South African motorists, whose return trips from the summer holidays were even cheaper than when they departed in December.

Since November, the price of 93-octane petrol on the Reef has declined by healthy 18% en fuel prices are back at 2017 levels. Last year, households spent approximately R100 billion on petroleum products and a drop of almost 20% in the price of a commodity that comprises almost 5% of the CPI basket is very good news indeed.

Apart from some meaningful financial relief for millions of South Africans, the lower fuel price also possesses a socio-political dividend, as it eliminates one of the reasons for protests and strikes, particularly by the mini-bus industry.

Last year, the unrest that accompanied fuel price-related protest action was accompanied by violence and widespread absenteeism and certainly put a dent in South Africa's already dubious productivity performance.

Rand recovers

South Africa's currency has also provided the economy with some welcome festive season cheer, at least from the perspective of importers and consumers.

Since the knock that the rand took in the wake of the aversion towards emerging markets, caused mainly by the problems in Argentina and Turkey during the third quarter of 2018, the rand has recovered by more than 10% against the US dollar.

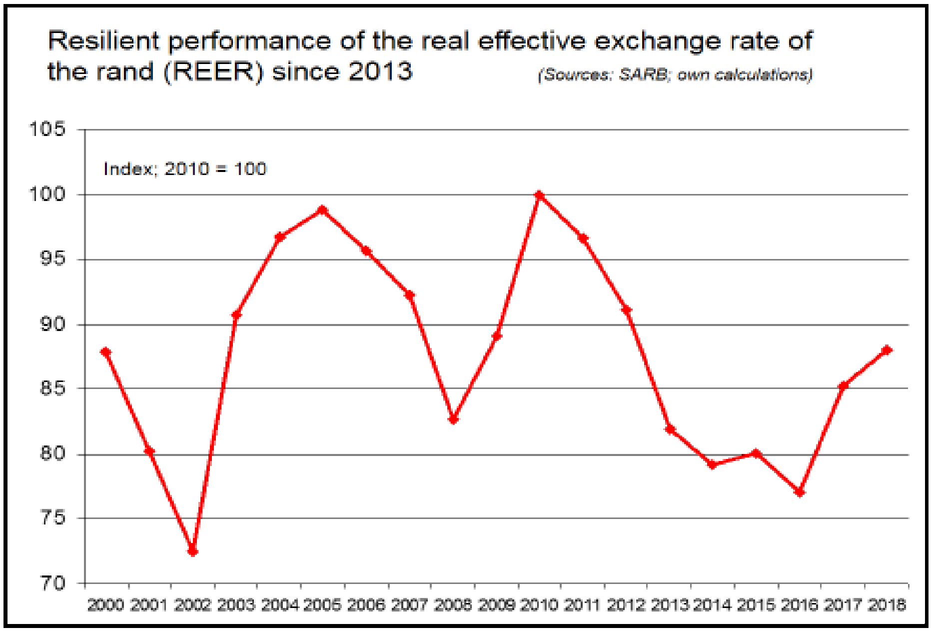
This is exceptionally good news for inflation expectations, as imports represent more than 27% of South Africa's GDP.

A weak currency stimulates exports and domestic manufacturing, but currency strength exerts downward pressure on inflation, something that the Reserve Bank's Monetary Policy Committee (MPC) did not see coming at all. In fact, the MPC has been hugely embarrassed by the dual deflationary effect of lower fuel prices and a stronger currency.

This Committee, which has the sole discretion to decide on arguably the most important indicator in the economy, has repeatedly made the wrong call on inflation expectations, ostensibly guided by an unscientific survey amongst financial analysts and representatives from business and trade unions, who more often than not, over-estimate future inflation trends.

A cursory analysis of the current composition of modest inflationary pressure in South Africa reveals three major causes, namely administered prices, higher fuel prices and some measure of the lagged effect of currency weakness.

The latter, however, is nothing to get too excited about, as the rand's real effective exchange rate is on par with its level of 18 years ago and has gained more than 14% from its average level in 2016.



The country's inflation rate averaged less than 5% last year and has remained within the Reserve bank's target range for 20 successive quarters.

Wage growth slows

Furthermore, the rate of increase in nominal labour costs has also slowed down. Year-on-year growth in average nominal salaries averaged 6.6% in 2016 and increased to 8.5% in 2017. During the first three quarters of 2018, this rate dropped to only 4.6%

When viewed against the modest increase in average labour remuneration during 2018, recent currency strength and the sharp drop in the fuel price, it is clear that high inflation does not pose any threat to fundamental macroeconomic stability in South Africa. High unemployment does.

With a bit of luck, the repo rate's next move will be downward. It has been long overdue, but the MPC has fortunately now run out of excuses to continue with a monetary policy stance that impedes growth and employment creation.