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Food product manufactures to remain under pressure as input costs continue to rise – 26 May 2016

The latest producer price index data (PPI) released by Statistics South Africa indicated that in April 2016, producer inflation slowed to 7% from 7.1% year-on-year (y/y), in March 2016. Meanwhile, the food products inflation accelerated to 10.9% from 10.5% y/y in March 2016.

The food products basket consists of four broad categories, which include “**meat, fish, fruit, vegetables, oils and fats**”, “**dairy products**”, “**grain mill products, starches and starch products, and animal feeds**” and “**other food products**”. Each of the above-mentioned categories within the food products basket is allocated a weight, with the largest being “**meat, fish, fruit, vegetables, oils and fats**” and “**other food products**”, which make up 37% and 41%, respectively (figure 1).

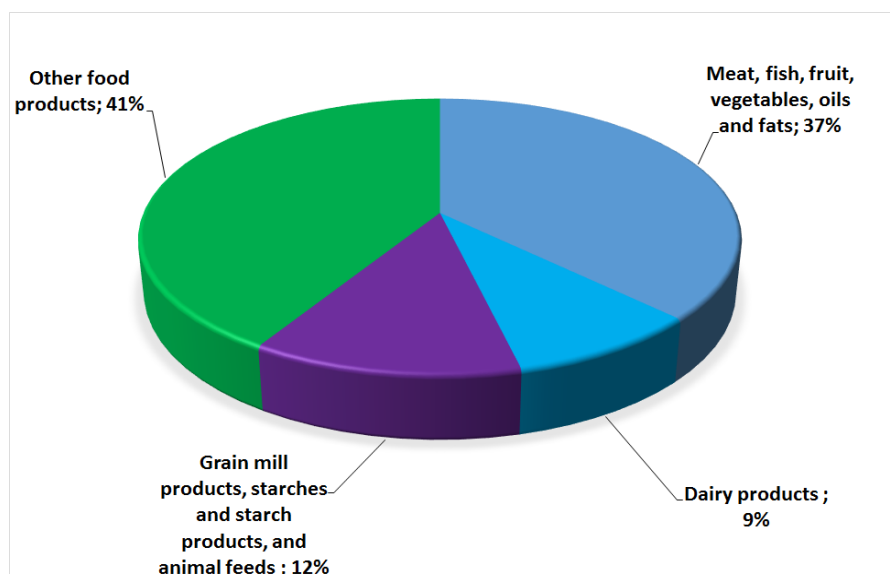


Figure 1: Weights of products in the food manufacturing basket

Source: Statistics South Africa, Agbiz Research

Overall, increases in the PPI for food products have largely been driven by an increase in soft commodity prices due to lower supplies on the back of the ongoing drought. The largest year-on-year percentage increases were recorded in the “**grain mill products, starches and starch products**” and “**other food products**”, which rose by 17.5%, and 12.3% y/y, respectively. “**Meat, fish, fruit, vegetables, oils and fats**” increased by 9% y/y, whereas **dairy products** increased by 3.3% y/y.

Driving producer inflation increases for “**grain mill products, starches and starch products**” are “grain mill products” which increased by 21% y/y, and “starches, starch products and animal feeds” which rose by 14.9% (**figure 2**).

Increase in “**Meat, fish, fruit, vegetables, oils and fats**” producer inflation has been driven by “oil and fats” which increased by 25.9%, “fish and fish products” (13.8%), “fruit and vegetables” (9.4%), and “meat and meat products” (4%) (**figure 2**).

Meanwhile, “**dairy products**” increased by 3.3%; with “**other food products**” being driven by significant y/y increases in sugar (14.7%) and bakery products (11.7%) (**figure 2**).

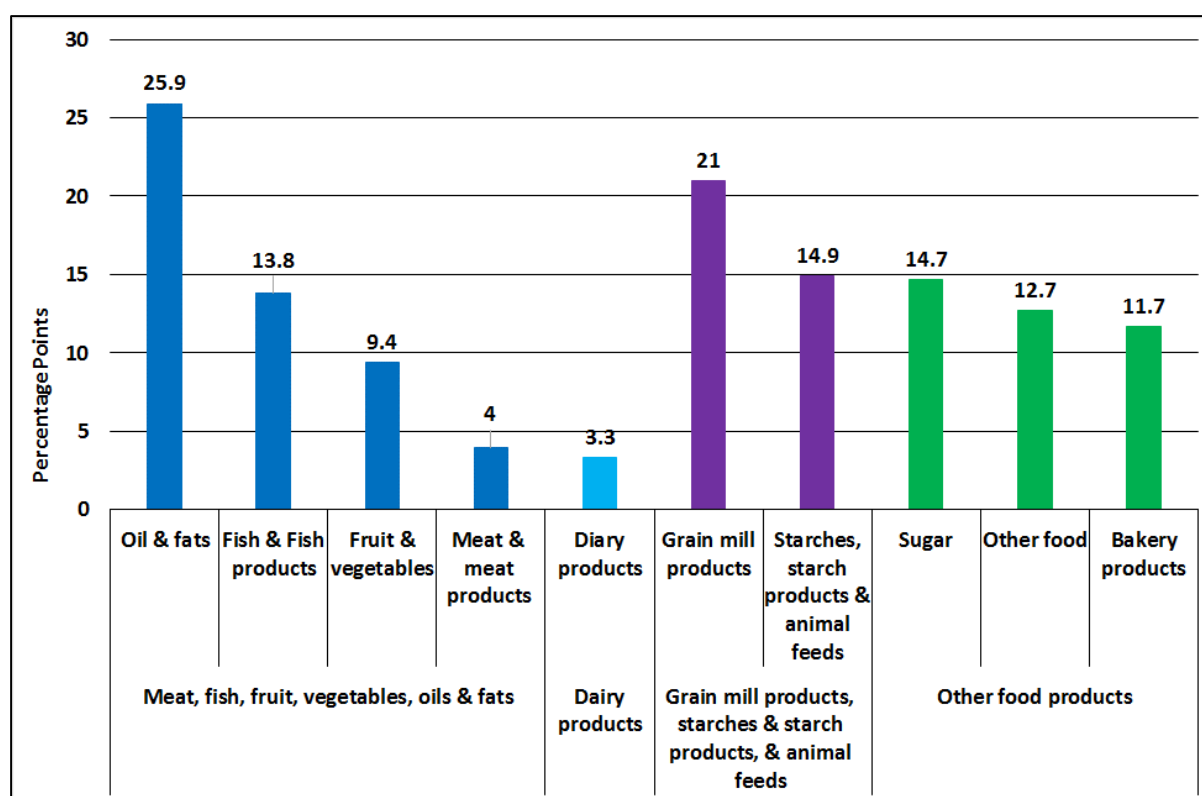


Figure 2: April 2016 y/y percentage growth

Source: Statistics South Africa, Agbiz Research

The increases in the PPI for food products discussed above, are a reflection of the agricultural commodities supply and demand dynamics, influenced by the following factors:

Imports - South Africa is set to be a net importer of grains and oilseeds this year. Wheat imports are forecast at 2 million tons for the 2015/16 season; whereas total maize and soybean imports forecast at 3.8 million and 300 000 tons in the 2016/17 season, respectively.

Drought – The drought has impacted all agricultural sub-sectors across the board, including the vegetable, fruit industry and livestock, where prices remain at higher levels. Grains and oilseed prices

have increased significantly, with white maize clawing above import parity prices, increasing by 70% y/y and with wheat prices also closely trailing import parity levels (**figure 3 and 4**).

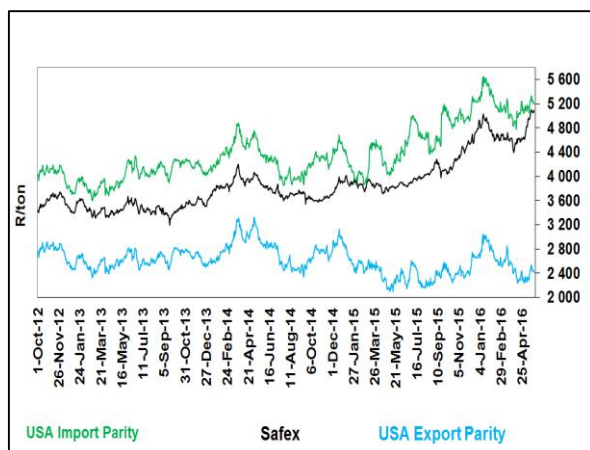


Figure 3: South African wheat prices

Source: Grain SA, Agbiz Research

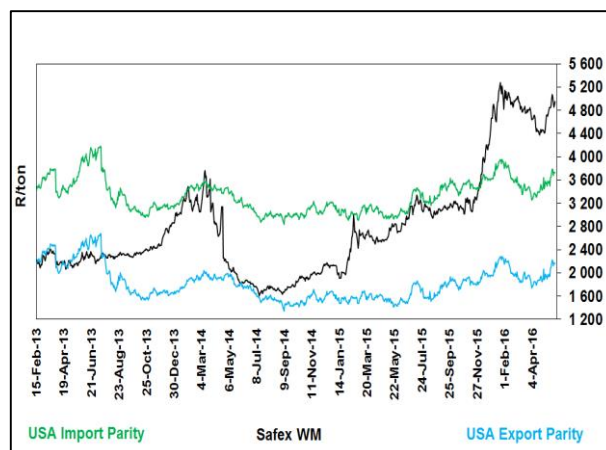


Figure 4: South African white maize prices

Source: Grain SA, Agbiz Research

Tariffs – the wheat tariff trebled over the past year, from R461 per ton in May 2015 to current levels of R1224.30 per ton. This significant increase in the tariff has, to some extent, added to the wheat price increases, which affect sectors such as grain milling and bakery products.

Rand/USD exchange rate – The Rand has weakened by 30% y/y, which has added to inflationary pressure on imports such as grains and oilseeds, all of which are critical inputs in all food manufacturing sub-sectors.

OUTLOOK

Import outlook – In the short to medium term, we expect grain and oilseeds commodities – critical inputs in food manufacturing – to remain at higher levels, at least until mid-2017, assuming that there will be favourable weather conditions in the 2016/17 production year to replenish market supplies.

Weather outlook - A number of weather forecasters already suggest that the El Nino event is at its final stages, with possibilities of La Nina event by end of the year already increased to 75%, according to the US Climate Prediction Centre. A La Nina weather event could lead to above normal rainfall in South Africa, which is essential to replenish soil moisture, and beneficial for crops and livestock.

Import tariffs – The wheat tariff is expected to increase by at least 30% from the current level of R1 224.30 per ton to levels of between R1 550 per ton and R1 591.40 per ton. All of this is expected put input costs of food manufactures in the grain milling and bakery products sub-sectors under pressure. Worth noting is a proposed review of the existing variable formulae for wheat, sugar and

maize import tariff from the Ministry of Finance, whose findings will have implications on food manufacture's input costs in the medium term.

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