Brief reflections on South Africa's consumer food price inflation

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It sometimes feels like there is little more to discuss regarding South Africa's consumer food price inflation. The local crop data continue to show that there are ample domestic supplies on the back of large harvests in field crops and horticulture, which would have ordinarily led to a decline in prices. Still, the question that repeatedly comes out in discussions with various stakeholders in the food industry is the impact of higher global prices on the domestic food market and whether this is the reason local prices have remained elevated in the face of a large harvest. This is an important consideration because the price developments we have witnessed in South Africa's soft commodities prices, specifically grains, in recent months reflect spillovers from the global market. This begs the question of where global grain prices are likely to go from here and how this could affect South Africa.

Before getting into outlook for global grains, let us recall that South Africa is typically a net exporter of maize and is therefore well integrated into global markets. Our rough calculations, using high-frequency data (daily data with more than 300 observations), shows that the correlation between domestic and international maize prices remains positive, about 60% for white maize (which is mainly traded into the African region) and 85% for yellow maize (which is traded into the global market). This implies that when global maize markets increase, domestic maize prices rise in tandem. Importantly, for wheat, rice and soybeans (and other vegetable oils), where South Africa is typically a net importer, the correlation between domestic and global prices is stronger.

Against this backdrop, last week's report that the FAO Global Food Index[1] averaged 127.1 points in May 2021, which is the biggest month-on-month gain since October 2010 and about 40% higher on a y/y basis would worry the local food industry stakeholders. This sharp increase was underpinned by a surge in prices for vegetable oils, sugar and cereals along with firmer meat and dairy prices, all of which South Africa is generally exposed to in the global market. The downgrade of production prospects in Brazil, dryness in parts of the US, the expected lower palm oil output in Southeast Asia, and the rising Chinese demand for grains, meat, dairy and oilseeds have been the primary drivers of prices these past few months.

But the data released at the end of May by the International Grains Council (IGC) suggests a change in the global grains supplies outlook in the 2021/22 production season. Firstly, the cold temperatures that had slowed plantings in parts of Europe have abated and plantings have now improved. Secondly, the US received beneficial rains, which improved the crop conditions and supported the plantings of the new crop. Lastly, the weather conditions in Ukraine and China have improved and supported the planting of the grain. As such, the IGC forecasts the 2021/22 global maize production at a new peak of 1,2 billion tonnes, up by 5% year-on-year (y/y). Nevertheless, the stocks could slightly down by 2% y/y to 261 million tonnes because of firmer consumption in the global feed industry, primarily supported by China. Notably, the improved weather conditions and production prospects in the aforementioned regions could slightly soften the commodity prices, albeit not to levels seen

[1] More information about the FAO Global Food Price Index can be accessed here: http://www.fao.org/worldfoodsituation/foodpricesindex/en/

last year because stocks are still set to be relatively low. Notably, the ongoing lack of clarity about the Southern Hemisphere crop (particularly in South America), which will only be planted in October, is another major source of uncertainty.

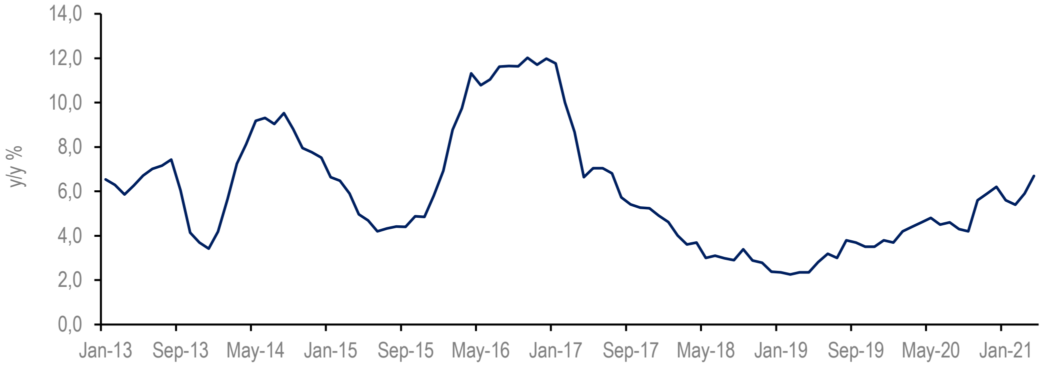
Similarly, the global wheat production conditions have improved. The IGC now forecasts 2021/22 global wheat production at a record 790 million tonnes, up 2% y/y. The global stocks for the same year are at 288 million tonnes, up by 1% y/y. These improvements point to a possible softening of global wheat prices in the coming months from the current highs. The global rice supplies and stocks are also at comfortable positions, well above the 2020/21 production season. We see a similar pattern in global soybeans production prospects, with 2021/11 harvest estimated at 383 million tonnes, up by 6% y/y. Meanwhile, stocks are estimated at 51 million tonnes, up by 10% y/y.

These production forecasts suggest that global crop prices from June 2021 going forward could soften slightly from the recent months' levels. That could also influence the South African consumer food price inflation outlook. However, the price developments in the case of soybeans will be influenced more by Chinese buying decisions and the broader vegetable oils market developments. The critical point is that global crop conditions are in a better state than in the past few months, which should be reflected in prices in the coming months.

The unique factor to South Africa, which stakeholders in the food industry will have to monitor consistently, is the impact is the biosecurity challenges. The most recent announcements of the foot and mouth disease in parts of KwaZulu-Natal and the ban of South Africa's beef in various export markets is one such disease to monitor, along with the African swine fever and Avian influenza. While these diseases are damaging and costly for farmers, they tend to lead to a decline in domestic meat prices due to the ban in exports, subsequently bode positively for local consumer food price inflation in the near-to-medium term.

Overall, these are all developments that we continue monitoring. Based on the expected sizeable domestic harvest, the expected softening in global grains prices, and recent developments in the meat industry, we are inclined to believe that South Africa's consumer food price inflation could ease from the second quarter of the year. Hence, we, for now, maintain a view that consumer food price inflation will likely average around 5,5% y/y in 2021.

Exhibit 1: South Africa's consumer food price inflation



Source: Stats SA and Agbiz Research

Weekly highlights

SA agricultural employment down 8% y/y in Q1, 2021

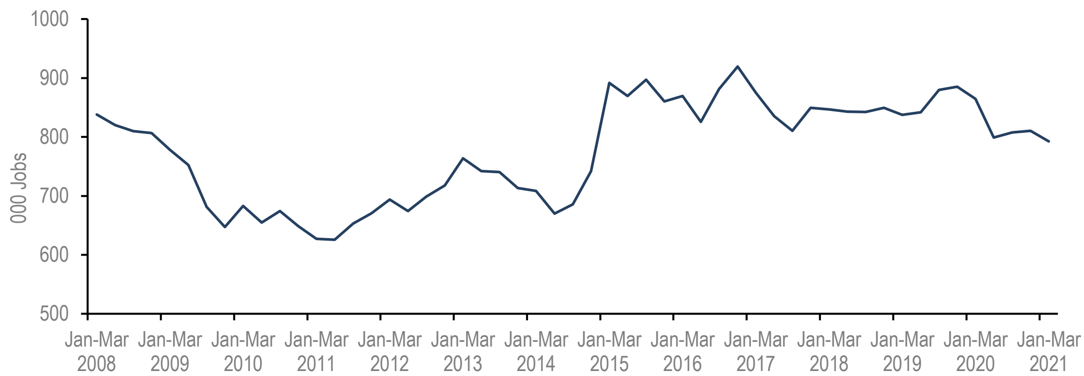
As we outlined last week, South Africa's agricultural sector is in its second consecutive year of good performance supported by favourable rainfall and expansion in plantings. In 2020, the sector's gross value added expanded by 13,1% y/y, and this year will likely also be another year of good performance. While we expect better crop harvests than 2020, the expansion could be 5% y/y because last year's base is already quite strong. Yet, the agricultural jobs data continue to disappoint. In the first quarter of 2021, South Africa's agricultural jobs were down by 8% y/y, with 792 000 people employed. This is the lowest level since 2014, which was a drought year. But we are not in a drought season at the moment. The decline in jobs seems to be concentrated within industries affected by various regulations in the lockdown period, such as the horticulture (wine grapes) and game industries.

From a provincial perspective, the job losses were reported in the Western Cape, Northern Cape, Free State, KwaZulu-Natal and North West, with the rest of the provinces registering an uptick from the first quarter of 2020. To underscore our point about the provinces hard hit by the lockdown regulations being the ones that experienced a notable decline in employment, consider the Western Cape, where agricultural jobs fell by 47% in the first quarter of 2021 compared to the corresponding period the previous year. The Western Cape's agricultural employment is now at its lowest since 2014, at 136 000. We suspect that the tail-end effects of the ban on wine and alcohol sales continue to constrain farmers' finances. The same is true for the Northern Cape, which experienced job losses, albeit at a relatively lower scale than the Western Cape.

For other provinces that are not in wine production, it is also plausible that social distancing measures that are in place to limit the spread of the pandemic might have contributed to the decline in employment, especially for seasonal workers. We say this because the Free State, North West and KwaZulu-Natal are among provinces with good activity in field crop, horticulture, and livestock subsectors in a year of favourable rains that allowed for expansion in area farmed. That said, it is important to mention that the different sub-sectors of agriculture have varying levels of labour intensity. The horticulture industries tend to be more labour-intensive while field crops and livestock are relatively more mechanised.

The employment data will be of interest in the coming months following the 16,1% increase in the farm minimum wage to R21,69 per hour with effect on 1 March. Various commodity groups, especially those heavily affected by the lockdown regulations, have indicated that the recent increase in the minimum wage could cause a further squeeze on cash flow and negatively influence hiring decisions. Nevertheless, the actual effects of the current minimum wage increase on jobs will only be apparent with a lag.

Exhibit 2: South Africa's agriculture employment



Source: Stats SA and Agbiz Research

Data releases this week

We start the week with the **US Crop Progress report** on the global agricultural data calendar, which will be released by the United States Department of Agriculture (USDA) today. The previous report of 01 June showed that US maize planting was nearing completion, with 95% of the intended area already planted in maize, with soybeans at 84%, and ahead of last year's pace on the same day. Another essential piece of data on the global market is the **USDA's World Agricultural Supply and Demand Estimates report**, which is due on Thursday. The focus will likely be on South America's 2020/21 crop and the global crop forecasts for the 2021/22 season. The IGC has already painted an optimistic picture for the new season; we look forward to seeing if the USDA will maintain a similar view. The **US weekly export sales data** is due for release also on Thursday.

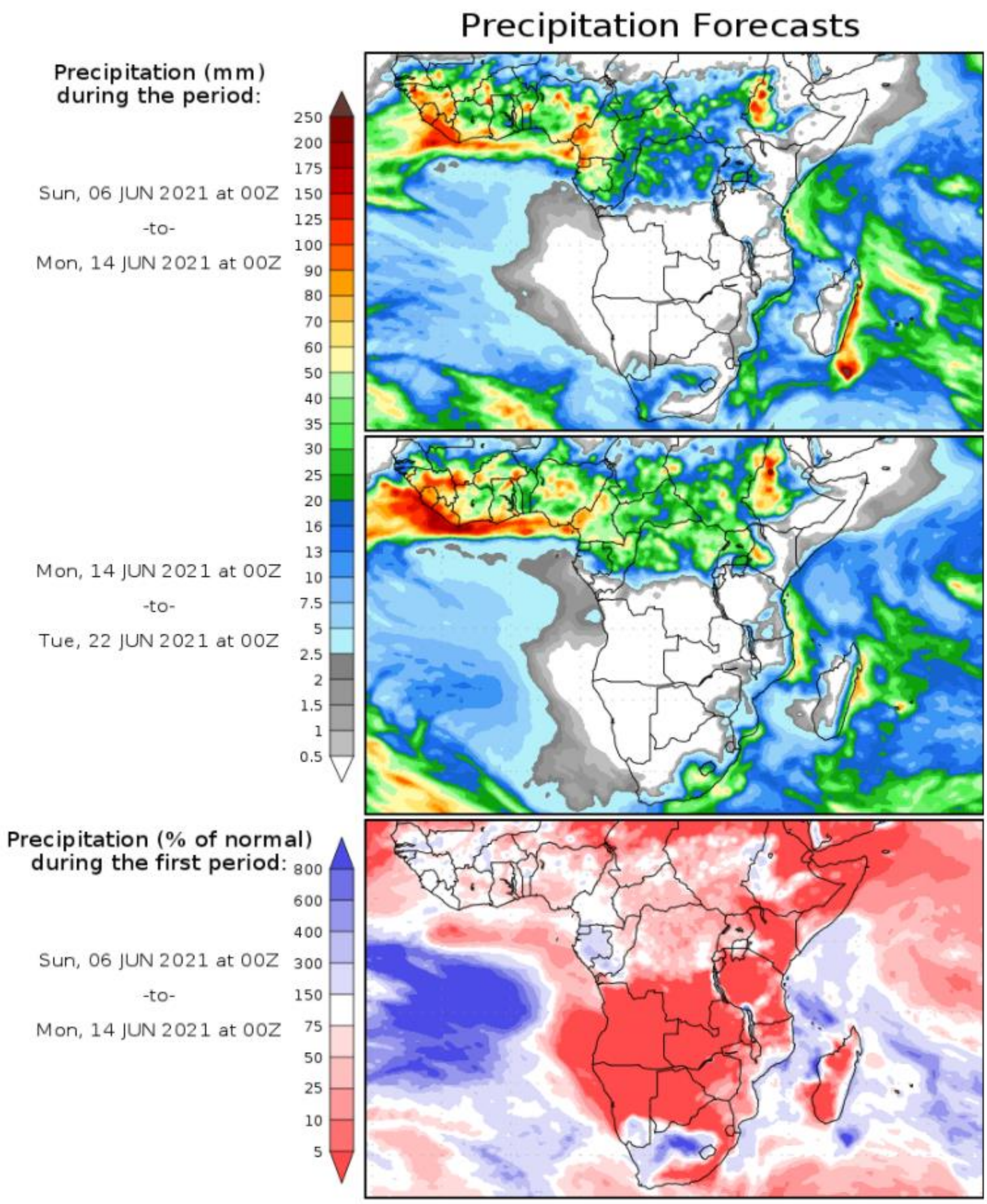
On the domestic front, on Tuesday, Statistics South Africa will release the **Gross Domestic Product (GDP) data** for the first quarter of the year. We expect a modest uptick in agriculture's gross value-added, supported by broad improvement in agricultural conditions across all subsectors.

On Wednesday, SAGIS will release the **Weekly Grain Producer Deliveries data** for 04 June. This data cover summer and winter crops, although we only focus on summer crops for now as the harvesting process gains momentum, particularly on oilseeds. To recap, on 28 May, about 17 889 tonnes of soybeans were delivered to commercial silos. This placed the soybean producer deliveries for the thirteenth week of the 2021/22 marketing year at 1,71 million tonnes, which equals 89% of the expected harvest of 1,92 million tonnes. Moreover, 397 031 tonnes of sunflower seed for the 2021/22 season had already been delivered to commercial silos in the same week, out of the expected crop of 716 240 tonnes.

In maize, the marketing year is different from the oilseeds; we are still in the fourth week of the 2021/22 marketing year, which began at the start of May. The producer deliveries currently amount to 3,7 million tonnes, out of the Crop Estimates Committee's expected harvest of 16,2 million tonnes (compared to our estimate of 16,7 million tonnes).

On Thursday, SAGIS will release the **Weekly Grain Trade data** for the week of 04 June. In the week of 28 March, which is the fourth week of South Africa's 2021/22 maize marketing year, total maize exports amounted to 233 334 tonnes. The seasonal export forecast is 2,8 million tonnes (up 10% y/y) because of the expected sizeable domestic harvest. In terms of wheat, South Africa is a net importer. On 28 May, imports amounted to 1,0 million tonnes, equating to 63% of the seasonal import forecast of 1,58 million tonnes.

Exhibit 3: South Africa's precipitation forecast



Source: George Mason University (wxmaps)

After heavy showers in some of the eastern regions of South Africa this past week, there could be reprieve. The weather forecast for this week shows clear skies over most regions of South Africa, which is supportive of the summer crop harvest process.

The only regions that could receive rains are the western parts of the country, and this is welcome developments as it could support the winter crops.