



Dairy market trends

February 2020

Dairy Market Trends February 2020

Executive summary

The MPO welcomes the upward move in producer prices. Farm economics on dairy farms have been negative for the major part of 2018, the whole of 2019 and it continued into 2020. The effect of cost cutting and the postponement of maintenance on dairy farms in an effort to stay in production has reduced capacity and responsiveness leaving farm profitability still in the negative with fodder banks and reserves depleted.

Unprocessed milk production for January 2020 is estimated at 283 million litres, 0.01% less than in January 2019. Milk production in January 2020 indicates stagnation in the primary sector. Cumulative unprocessed milk production for 2019 (inclusive of December) was 3 314 million litres indicating a marginal growth of only 0,23%.

For the period ending December 2019, the SA dairy industry continued to be a net exporter of dairy products (net exports equal 57 million litres milk equivalent).

Dairy demand is still positive despite the struggling SA economy and disposable income of consumers being under pressure, but the growth is subdued. An industry that can produce these levels of sales growth amid timid consumer financials needs to be looked after. The capacity in the value chain needs to be nurtured especially at farmer level given the multiplier effect up and down the value chain. If the industry can guard this capacity it will shine even more when proper economic growth is achieved in future.

Producer price increases announced by the different milk processors are a mixed bag of one increase on 1 March, some spread over three months starting 1 March (3x10cents / litre) and some including a winter premium. The weighted national average (which is not an exact science due to some company's pricing structure being very complex versus others being only one price) for March is R4.62. This equals a total price movement of 32 cents / litre (7.44%). The milk:feed price ratio has been below 1,2:1 for the past three months and the slowdown in production in 2019 reflects the poor economy in unprocessed milk production. In simulating the most optimistic effect of the increased producer price for March 2020 and assuming a reducing trend in the derived feed cost price from the current level of R3656/ton to R3 500/ton for March, the effect will only improve the milk:feed price ratio from 1,20:1 to 1,32:1, which is still 6 to 16% below the required breakeven of 1,40: 1 . With the current milk:feed ration we are almost at the same levels as in 2016 – this is not sustainable! This level of improvement will not do much to stimulate unprocessed milk production. **The assumption in the reduced derived feed price is only illustratively since there are no indication that the derived feed price will reduce in March.** If the feed cost in March stays at the same level as in February (which is the most probable), the ratio improves to 1,26:1. This will not change farm economics enough to stimulate production.

On the back of a favourable crop estimate for the 2020 maize crop prices reacted with the derived feed price reducing by 4% in February. It is still early days before the crop will be in the silos but market reaction resulted in July yellow maize futures on Safex dropping below R2 500/ton on 6 March 2020. This should provide some relief regarding feed cost but only from June onwards.

International prices for milk powders, butter and cheddar cheese as reported by the United States Department of Agriculture (USDA) inclusive of February 2020 is continuing the upward trend which started at the beginning of 2019 and was led by cheese with butter providing further momentum.

In Rand terms all product prices increased from January 2019 to February 2020 with butter up by 10%, SMP 38%, cheese 31% and FMP by 24%. The magnitude of the Rand increases was bolstered by the Rand depreciating by 8% over the time period.

In USD terms over the same period butter is up by 2%, SMP 28%, cheese 21% and FMP 15%.

The main reasons for the hike in international prices is limited export availability, which is the result of adverse climatic conditions in New Zealand and Australia on the one hand and a cycle of low producer price in the main exporting countries during 2018/19 on the other hand. This provided the impetus for producer prices in the US to increase by 34% since January 2019 and with 13% in New Zealand over the same period.

The effect of product flow on the international market due to the cocooning of countries as a result of Covid-19 could result in turmoil on the international market with some markets experiencing opposite forces regarding demand and supply.

The SA economy contracted with 3.2% in the first quarter of 2019, in the second quarter a growth rate of 3.1% was achieved, in the third quarter it contracted again with 0.8% and in the last quarter of 2019 the economy has contracted with 1,4%. The consecutive quarterly contractions placed SA in a technical recession. The SA economy registered a marginal growth rate of 0,2% for the full year 2019 which is the lowest in past 10 years. The magnitude of the decay in government departments and parastatals has been underestimated and will take longer to fix. In the fourth quarter of 2019 agriculture contracted by 7.6%, manufacturing 1.8%, construction 5.9%, electricity 4.0%, trade 3.8%, the government 0.4% and transport 7.2%. Mining and financial services grew respectively with 1.8% and 2.7%. The growth rate of the SA economy has been around 1% since 2015 and that is the elephant in the room. The main focus of the Minister of Finance in the 2020 budget speech on reducing government expenditure provides insight in the understanding of the poor status of the SA economy. However, one needs to point out that although it is a step in the right direction the only way to stop the unsustainable growth in government debt as a percentage Gross Domestic Product (GDP) is through high levels of economic growth.

In a free market economy where supply and demand reflects the scarcity of the different production factors the entrepreneur is the link in optimising these factors and creating competition. As soon as government's share of the economy becomes too big the role of the entrepreneur is suppressed leading to less optimisation and competition.

If economic growth is realised the role of government in the economy should reduce while looking after infrastructure, the rule of law, education system, trade agreements, public health system and functioning government departments at all levels of government. Furthermore growth policies or programmes should guard against all sorts of prefixes and warped economic concepts. "Inclusive economic growth" should be "economic growth" There is wide appreciation of the need to alleviate poverty and to expand wealth but first get the formula for economic growth in the SA context right. In the process the income tax base will increase leading to increased income for the government. Once high growth levels are achieved other leavers can be employed to enhance inclusivity. Beware of being prescriptive to the entrepreneur on how to do business, with whom business can be conducted, who must be employed and the fatal encroachment of private rights. The track record of the ANC government regarding economic policy is poor, begging for a serious rethink. Unfortunately the new leadership inherited a ship full of breaches and holes and to top it all a Covid-19 pandemic.

Frequently milk producers and other role players ask about the meaning and implications of specific market trends on the total dairy market balance and how it will change future markets. While the Milk Producers' Organisation cannot and will not try to predict the future in any detail, the possible general impact of specific changes will be discussed in this document. This information should not be regarded as financial advice.

While this report is compiled from sources that are deemed to be reliable, MPO cannot take responsibility for any decisions based on the information in this report.

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1. Milk supply, demand and prices

1.1 Milk production

Unprocessed milk production for January 2020 is estimated at 283 million litres, 0.01% less than in January 2019. Milk production in January 2020 indicates stagnation in the primary sector. Cumulative unprocessed milk production for 2019 (inclusive of December) was 3 314 million litres indicating a marginal growth of only 0,23%.

Monthly milk production is reflected in Figure 1 below.

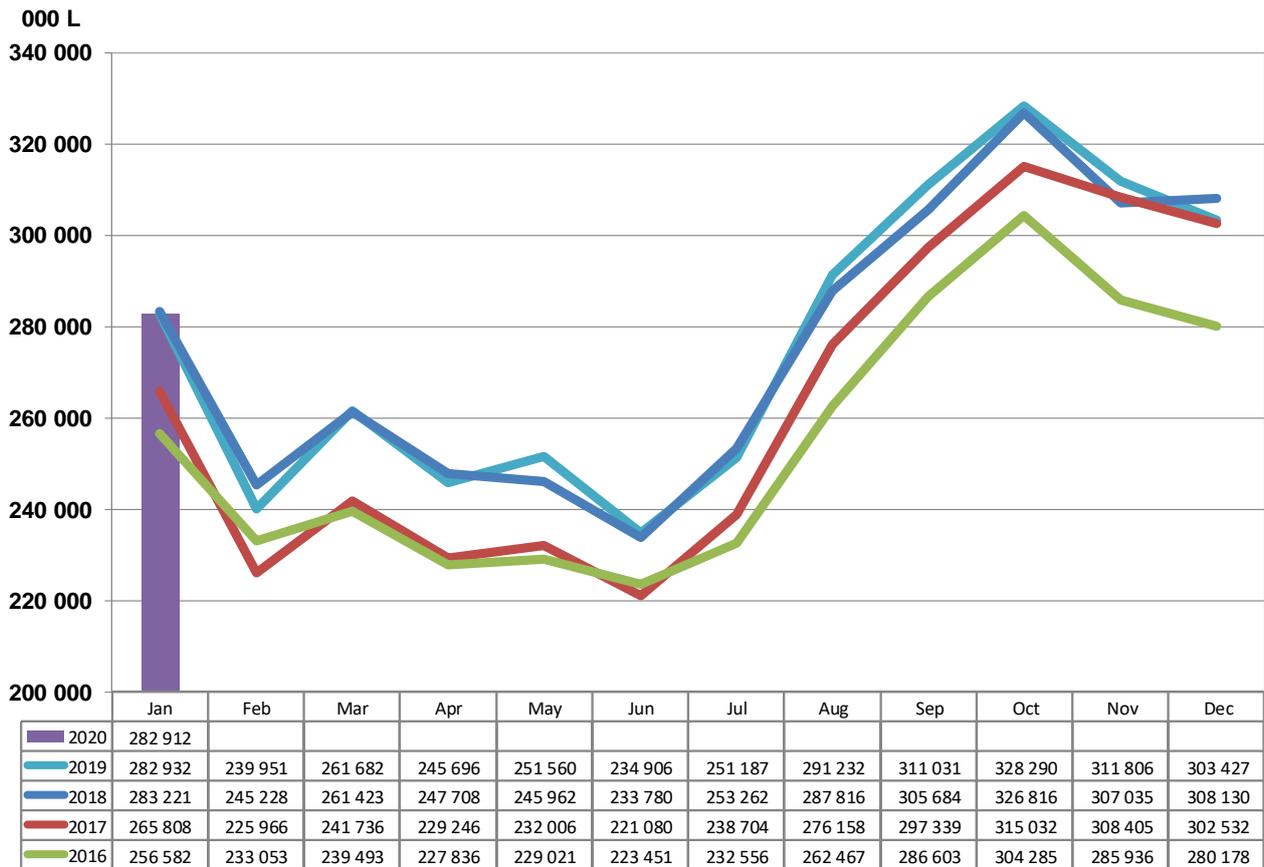


Figure 1 Monthly milk production ('000 L).

Source: Milk SA, December and January are preliminary

1.2 Dairy imports

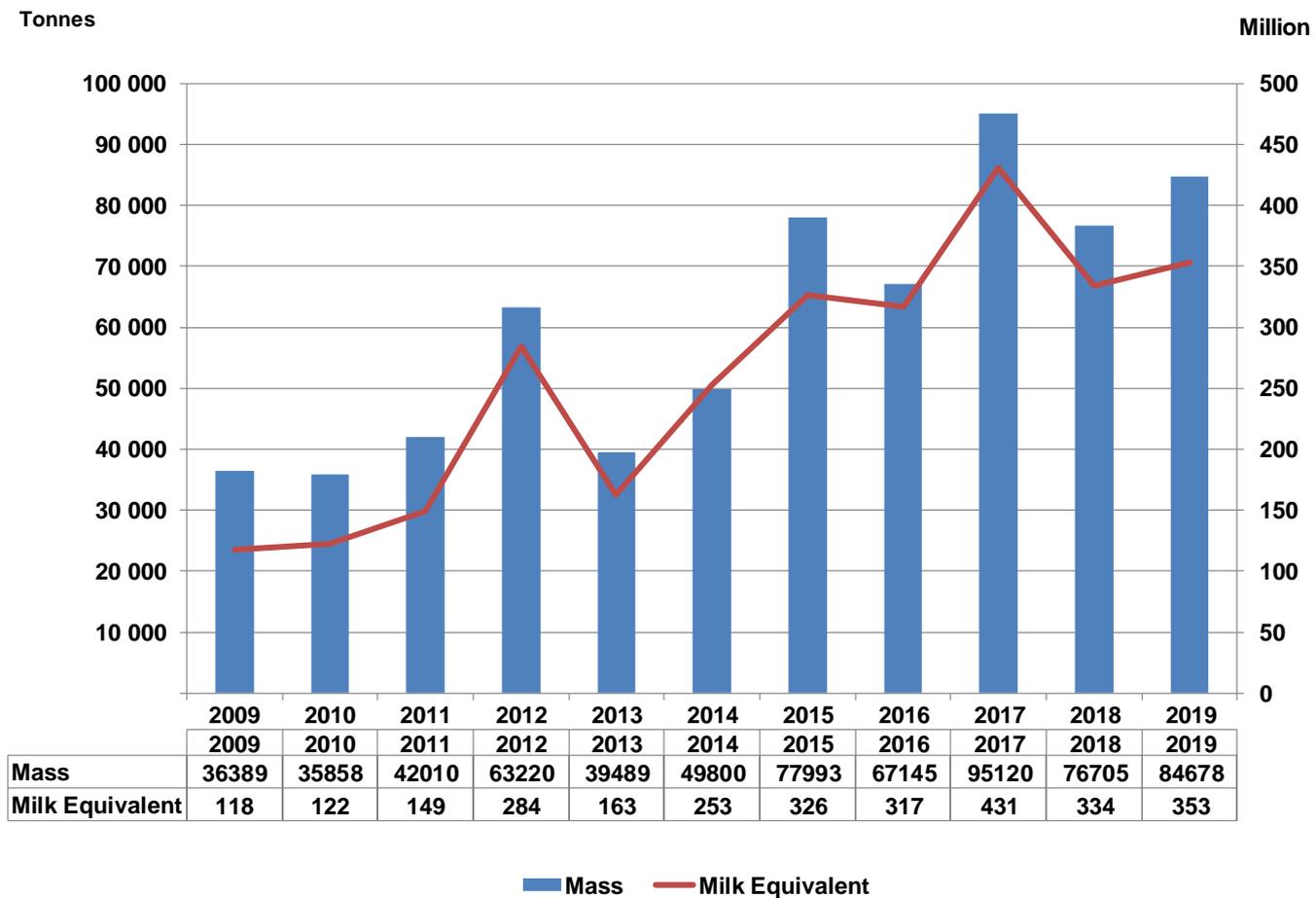


Figure 2 Annual imports, mass and milk equivalent basis, 2009-2019

Source: AgriInspec

Figure 2 illustrates the fluctuation in dairy imports on a mass and milk equivalent basis over the past 10 years. Imports for 2018 are at the same level as in 2015, registering a 19% drop in imports when compared to 2017. This is mainly due to reduced imports of UHT milk as a result of high levels of milk production in SA and the accelerated depreciation in the value of the rand in the second and third quarter of 2018. Imports in 2019 in terms of milk equivalent is 5,7% higher than in 2018 and in mass terms 10,4% more than in 2018. The increase in imports reflects the market interpretation of a slowdown in production during 2019 in the primary sector.

Figure 3 illustrates cumulative dairy imports. Dairy imports started off slow in 2019 but picked up later in the year with the effect that the 2019 imports was 5.7% higher than 2018, while being 18% lower than in 2017.

The January 2020 level of imports is more in line with the typical level of imports when compared to January 2019.

Million litres milk equivalent

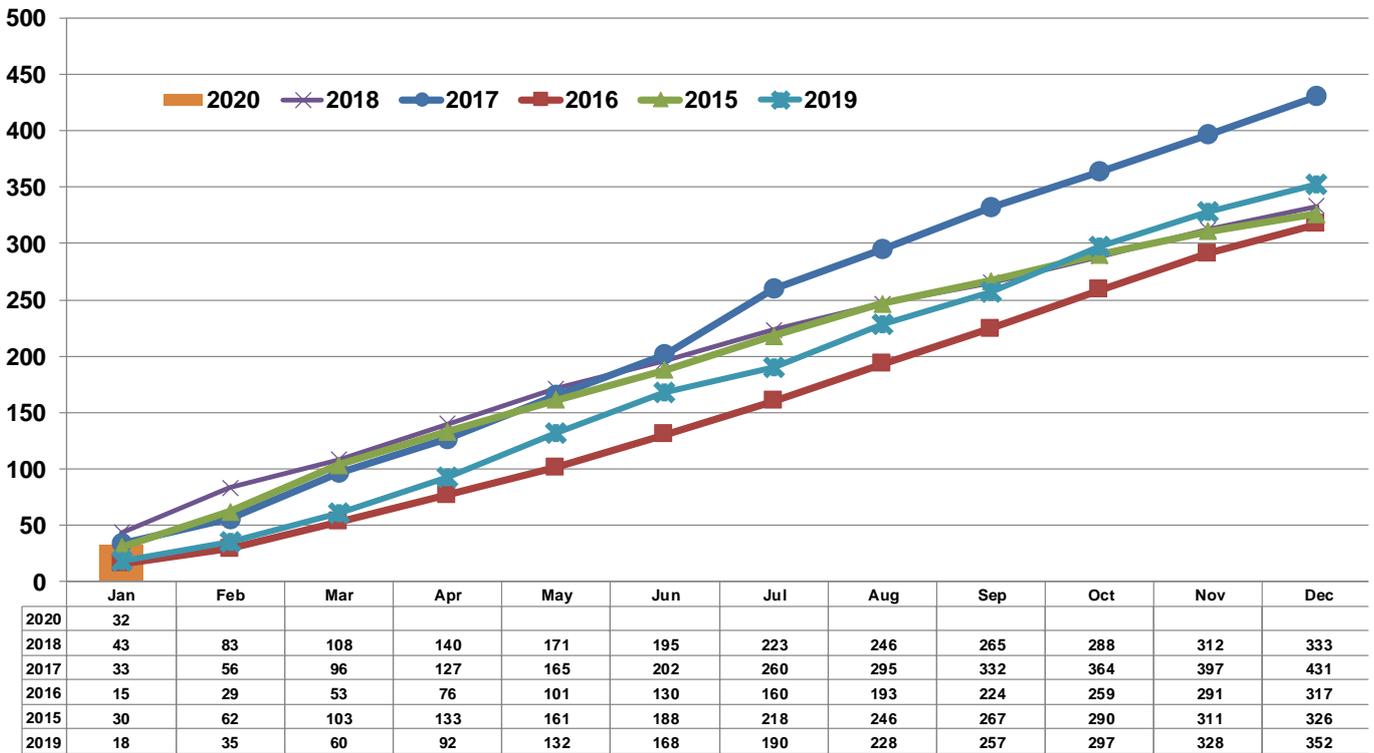


Figure 3 Monthly cumulative imports, (Mil. L.) milk equivalent basis

Source: Agrilnspec

1.3 Dairy exports and sales to BLNS countries

Monthly cumulative exports on a milk equivalent basis are reflected in Figure 4 below. Dairy exports maintained the same volumes as in the previous years. The 2019 exports, year to date, is slightly higher than the previous four years.

Exports in January 2020 is the highest compared to the previous 5 years.

This is an indication that export markets are well looked after by the SA exporters and that the markets are satisfied with the product range and quality.

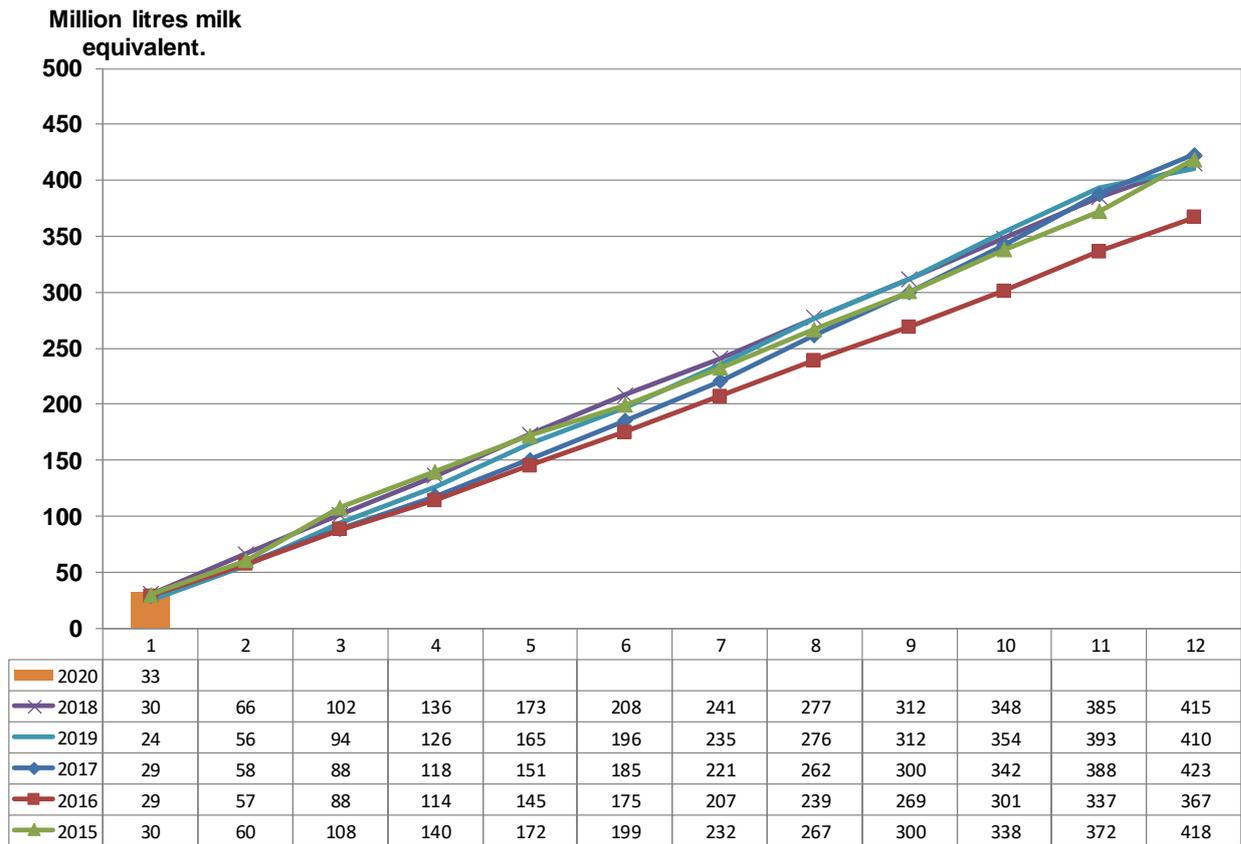


Figure 4 Monthly cumulative dairy exports (Mil. L.), milk equivalent basis

Source: Agrilnspec

1.4 Net exports (Inclusive of sales to BLNS countries)

For the period ending December 2019, the SA dairy industry continued to be a net exporter of dairy products (net exports equal 57 million litres milk equivalent).

The SA dairy industry regained its status as a net exporter of dairy products in 2018. Exports in 2018 exceeded imports with 82 million litres. Net exports in 2018 were higher than in 2017 and 2016 and only slightly below the level of 2015. Cumulative net exports (total exports plus sales to BLNS countries less total imports) on a milk equivalent basis are shown in Figure 5 below.

Mil. L. ME

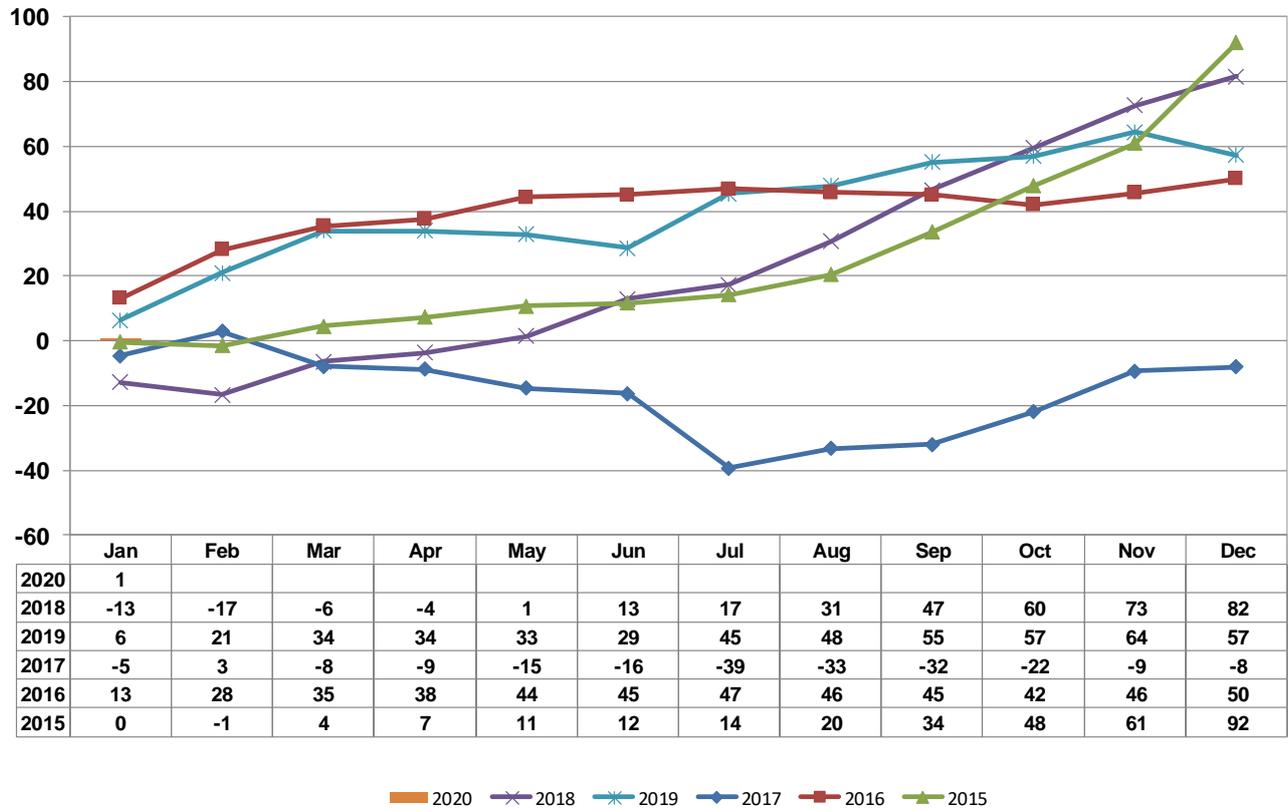


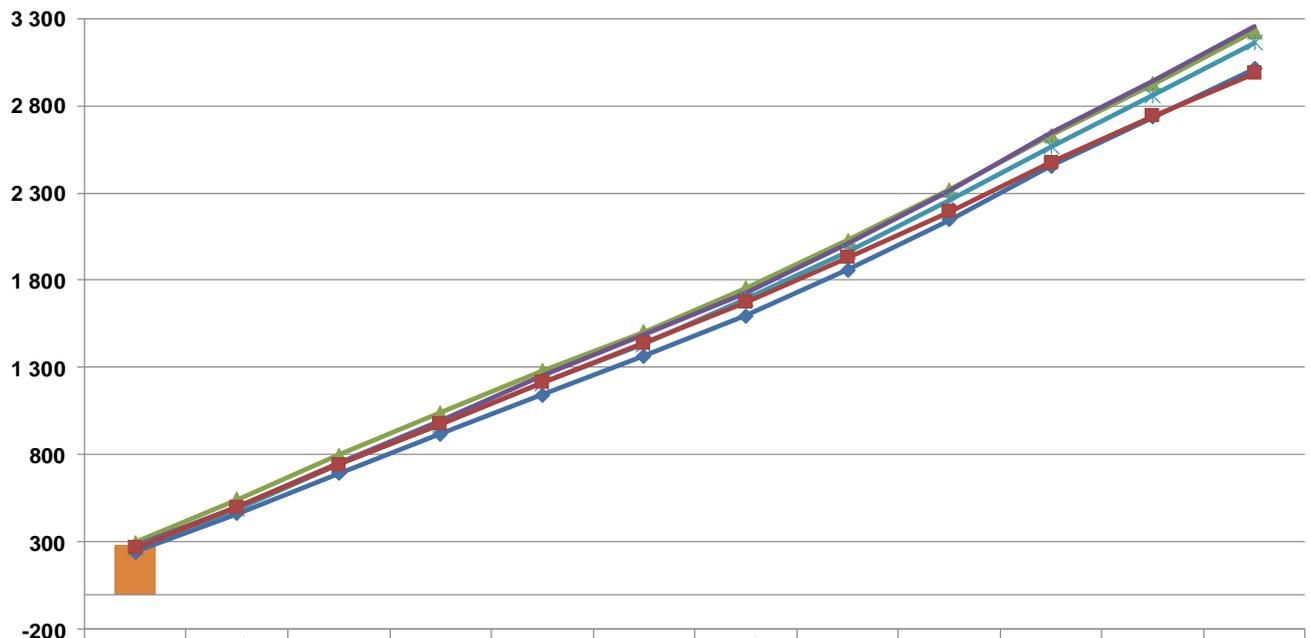
Figure 5 Cumulative net exports, milk equivalent basis (Mil. L.)

Source: Agrilnspec

1.5 Total milk supply

The total cumulative monthly supply of milk, consisting of locally produced milk less net exports (total exports inclusive of sales to BLNS countries less total imports) is reflected in Figure 6. The total cumulative supply of milk in 2019 is almost at the exact same level as in 2018.

Mil. Litres



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2020	282											
2018	296	545	796	1041	1282	1504	1753	2028	2317	2631	2925	3224
2019	277	502	751	996	1249	1488	1723	2011	2315	2642	2946	3256
2017	270	489	741	972	1209	1432	1694	1964	2260	2565	2861	3162
2016	243	462	694	919	1142	1364	1595	1859	2146	2453	2736	3011
2015	267	499	743	975	1212	1440	1674	1930	2194	2476	2741	2983

Figure 6 Total Cumulative monthly milk supply

Source: MPO calculation

1.6 Milk demand

Table 1 contains information with regard to the change in retail demand for different dairy products for the 12 month period from October 2017 to September 2018 compared to the 12 month period from October 2018 to September 2019 and the change in retail prices from September 2018 to September 2019. Only three of the nine products experienced a negative growth in sales volumes while four of the nine product prices increased with less than inflation. Four of the nine products experienced modest growth while yoghurt and maas had strong growth on the back of very low price increases.

Dairy demand illustrated in table 1 is still positive despite the struggling SA economy and disposable income of consumers being under pressure, but the growth is subdued. An industry that can produce these levels of sales growth amid timid consumer financials needs to be looked after. The capacity in the value chain needs to be nurtured especially at farmer level given the multiplier effect up and down the value chain. If the industry can guard this capacity it will shine even more when proper economic growth is achieved in future.

TABLE 1: PERCENTAGE CHANGE IN RETAIL SALES QUANTITIES FOR MAJOR DAIRY PRODUCTS FOR THE 12 MONTH PERIOD FROM October 2017 TO September 2018 COMPARED TO THE 12 MONTH PERIOD FROM October 2018 TO September 2019 AND THE CHANGE IN RETAIL PRICES FROM September 2018 TO September 2019

Product	Change in quantity sold %	Change in retail prices %
Fresh milk	-3.2	5.4
Long-life milk (UHT)	4.2	13.8
Flavoured milk	4.0	9.0
Yoghurt	9.3	2.2
Maas	22.3	1.9
Pre-packaged cheese	4.6	5.7
Cream cheese	-0.3	3.0
Butter	5.3	-1.2
Cream	-2.8	8.8

Source: Nielsen figures supplied by SAMPRO

1.7 Producer prices

Producer prices are indicated in Figure 7. The graph is calculated by the MPO based on information supplied by members and other role players, and is a national average. Increased producer prices from most processors were announced on a wide front effective from 1 March 2020. The effect on the national average producer price is 32 cents, with the price going to R4.62. In most cases winter premiums will take effect from 2 April 2020.

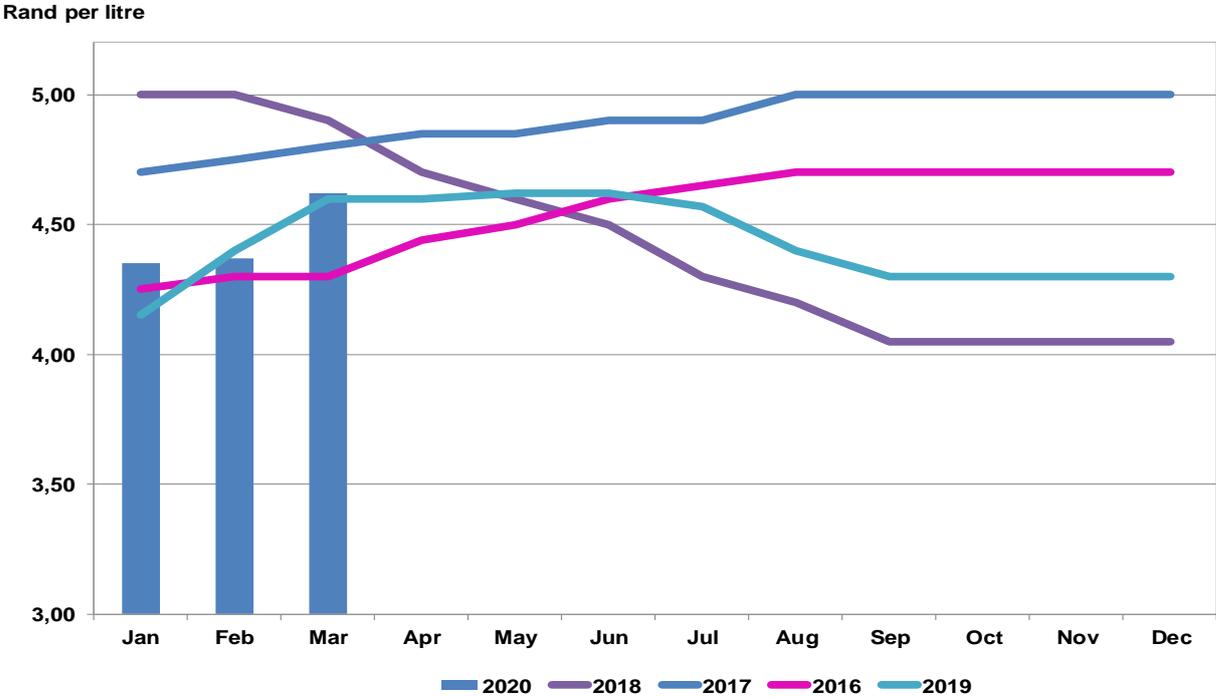


Figure 7 Monthly milk producer prices, 2015-2020

Source: MPO calculations

1.8 Retail prices

Retail prices of fresh milk in different packaging are supplied by the South African National Consumer Union (SANCU). The retail prices of fresh milk per litre for milk packaged in 2-litre plastic containers are compared to producer prices in Figure 8. The spread for September, October and November 2019 was at an all-time high.

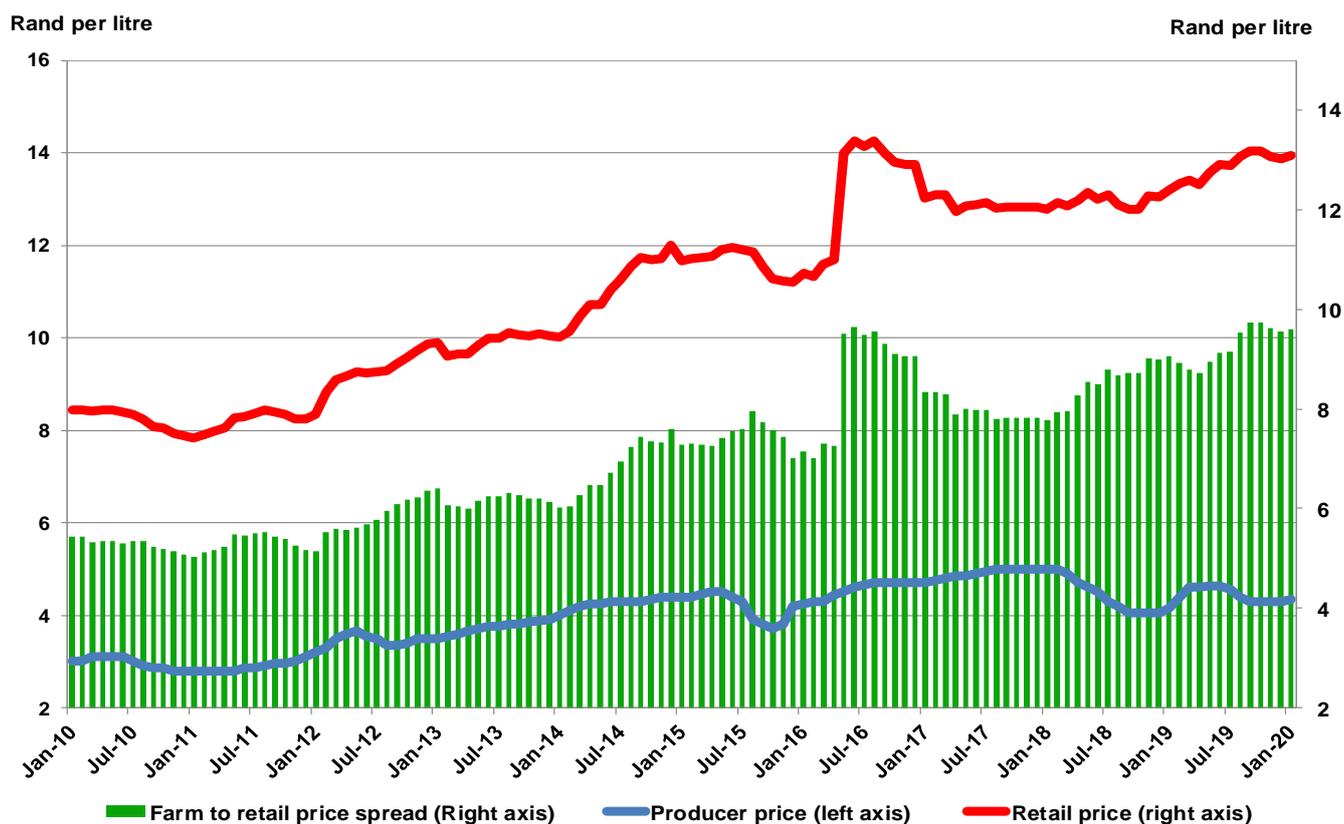


Figure 8 Monthly producer and retail prices, 2010- 2019

Source: MPO, SANCU

1.9 Feed prices

Feed cost is the most important cost item for milk producers. Internationally the price of maize and soybeans are used as a proxy for feed prices. A derived feed price is thus defined as the weighted price per kilogram of maize and soybeans (70% maize, 30% soybeans). Feed prices, based on Safex nearest month prices, are reflected in Figure 9. Farmers' production decisions are not based on absolute prices, but on relative prices. If producer milk prices decrease in relation to feed prices, farmers will tend to produce less, and if prices increase relative to feed prices, production will increase. Unfavourable milk: feed price ratios will result in slower production growth or lower production over time.

The upward trend in feed cost is clearly visible since July 2018 and continued into the first month of 2020. On the back of a favourable crop estimate for the 2020 maize crop, prices reacted with the derived feed price reducing by 4%. It is still early days before the crop will be in the silos but market reaction resulted in July yellow maize futures on Safex dropping below R2500/ton on 6 March 2020.

The milk: feed price ratio is illustrated in figure 10. The ratio has been below 1,2:1 for the past three months and the slowdown in unprocessed milk production in 2019 reflects the poor economy in unprocessed milk production. In simulating the most optimistic effect of the increased producer price for March 2020 by assuming a reduction in the derived feed cost price from the current level of R3 656/ton to R3500/ton for March, the milk:feed price ratio will improve from 1,20 to 1,31. This level of improvement will not do much to stimulate unprocessed milk production. **The assumption in the reduced derived feed price is only illustratively since there is no indication that the derived feed price will reduce in March.**

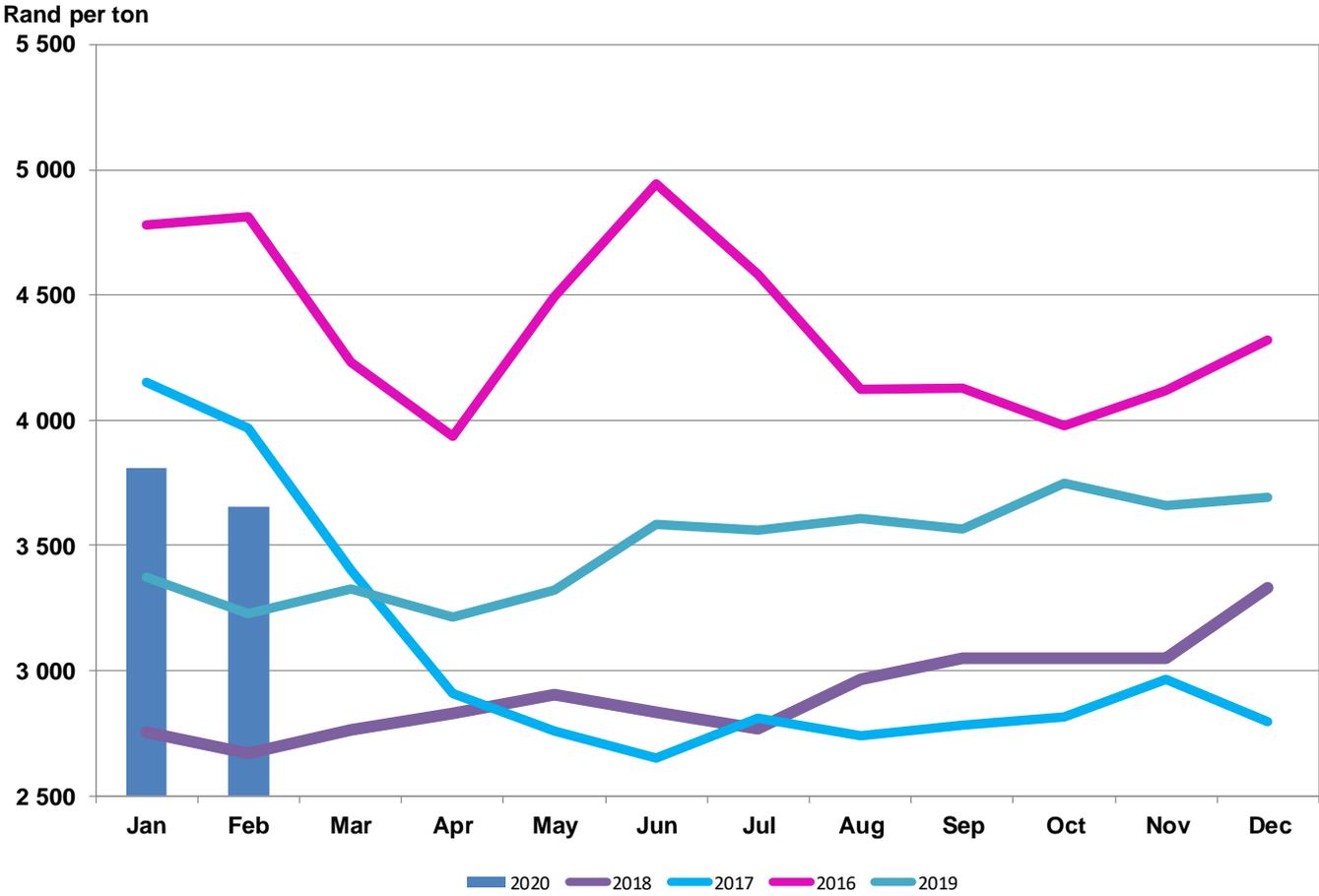


Figure 9 Calculated dairy feed prices, 2015-2019

Source: Safex nearest month data

Milk : feed price ratio

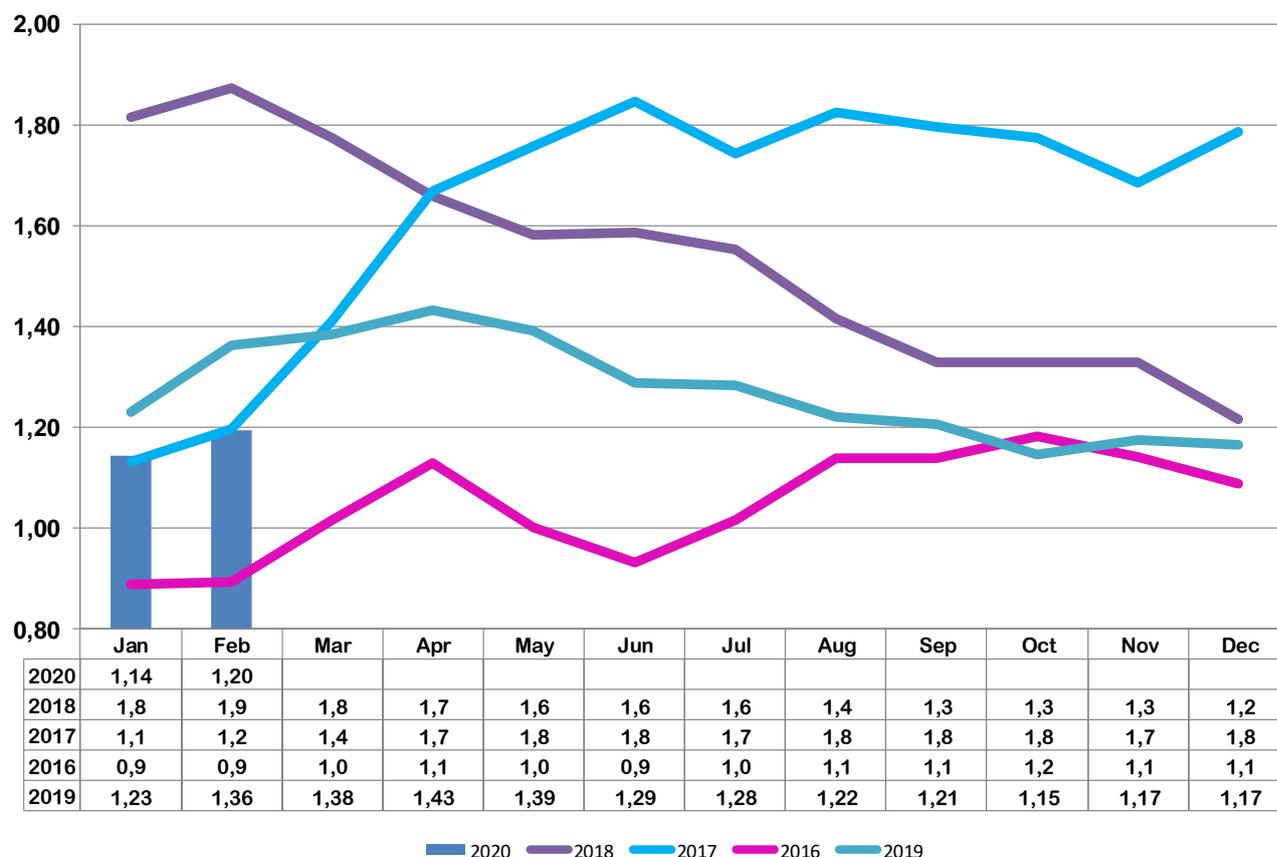


Figure 10 Milk: feed price ratio, 2015-2019

Source: MPO calculations

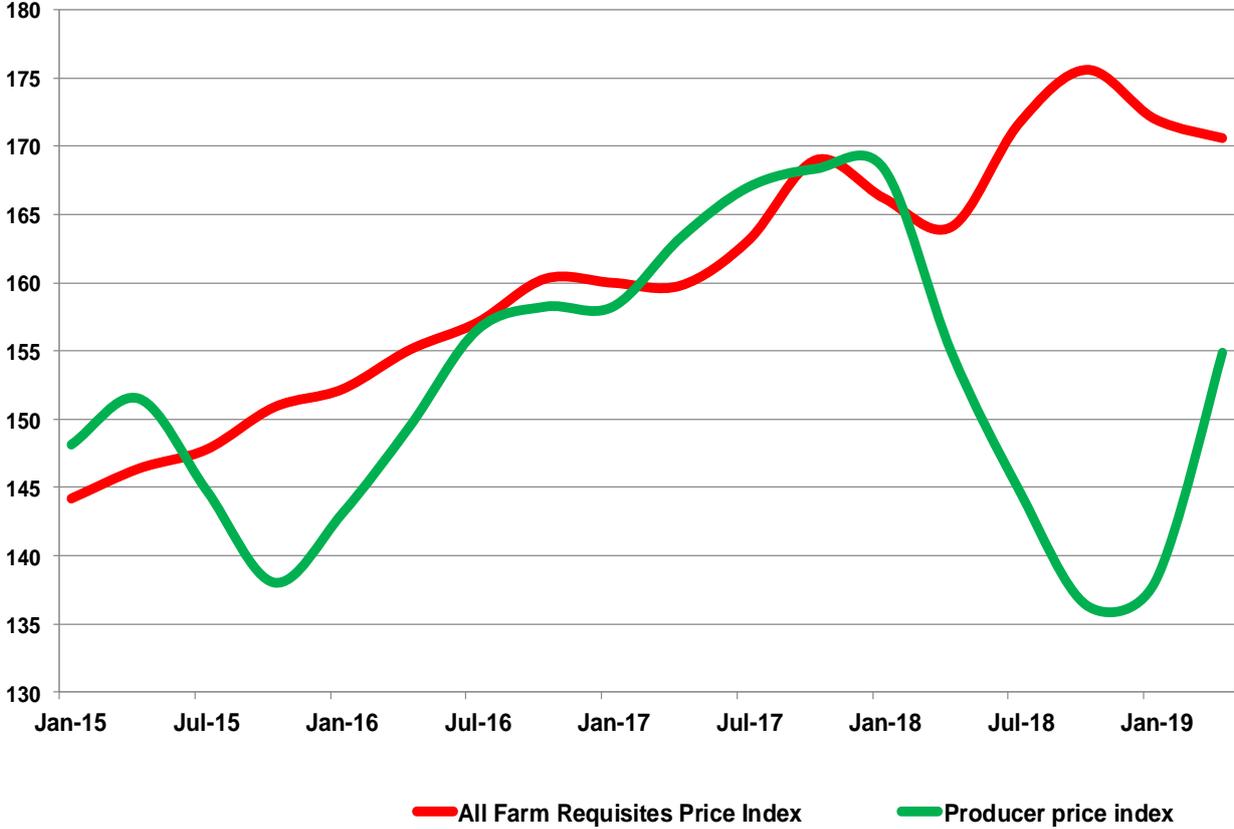
1.10 Input prices

The Department of Agriculture, Forestry and Fisheries publishes price indexes for farm requisites on a quarterly basis. As with all indexes, this index simplifies a very complex data-set to a level that does not correspond to individual farm data-sets. However, the trend in this index gives an indication of the direction of input price changes. The farm requisite index and producer price index are shown in Figure 11. The developments early in 2019 indicate that the cost price squeeze has reduced slightly, however still at a severe level. Cost management will be crucial over the coming months and optimising energy utilisation will play a big role in containing costs.

The slope of the downward trend in producer prices during 2018 is more severe than the slope of the trend that occurred in July 2015 which resulted in financial difficulty for many farmers. The downward trend depicted in the All Farm Requisite Price Index from the beginning of 2018 was reversed in the second quarter of 2018 on the back of the continued weak rand resulting in, amongst other, higher fuel and fertiliser prices. In the first quarter of 2019, the trend changed

and continued down in the second quarter. The producer price index reflects the price increases at the beginning of 2019.

Index (2010 = 100)



Source: DAFF, MPO calculation

Figure 11 Quarterly Farm Requisites Price Index and Producer Price Index

1.11 International prices

The FAO Food Price Index in February 2020 is 8,2% higher than same month in 2019. Buoyant prices in all the commodities, with the exception of cereals fuelled the index to its highest level since January 2015. However, as a whole the index is significantly lower (25%) than the peak in January 2011.

The Dairy price Index is 9,0% up from February 2019.

Index (2002 - 2004
= 100)

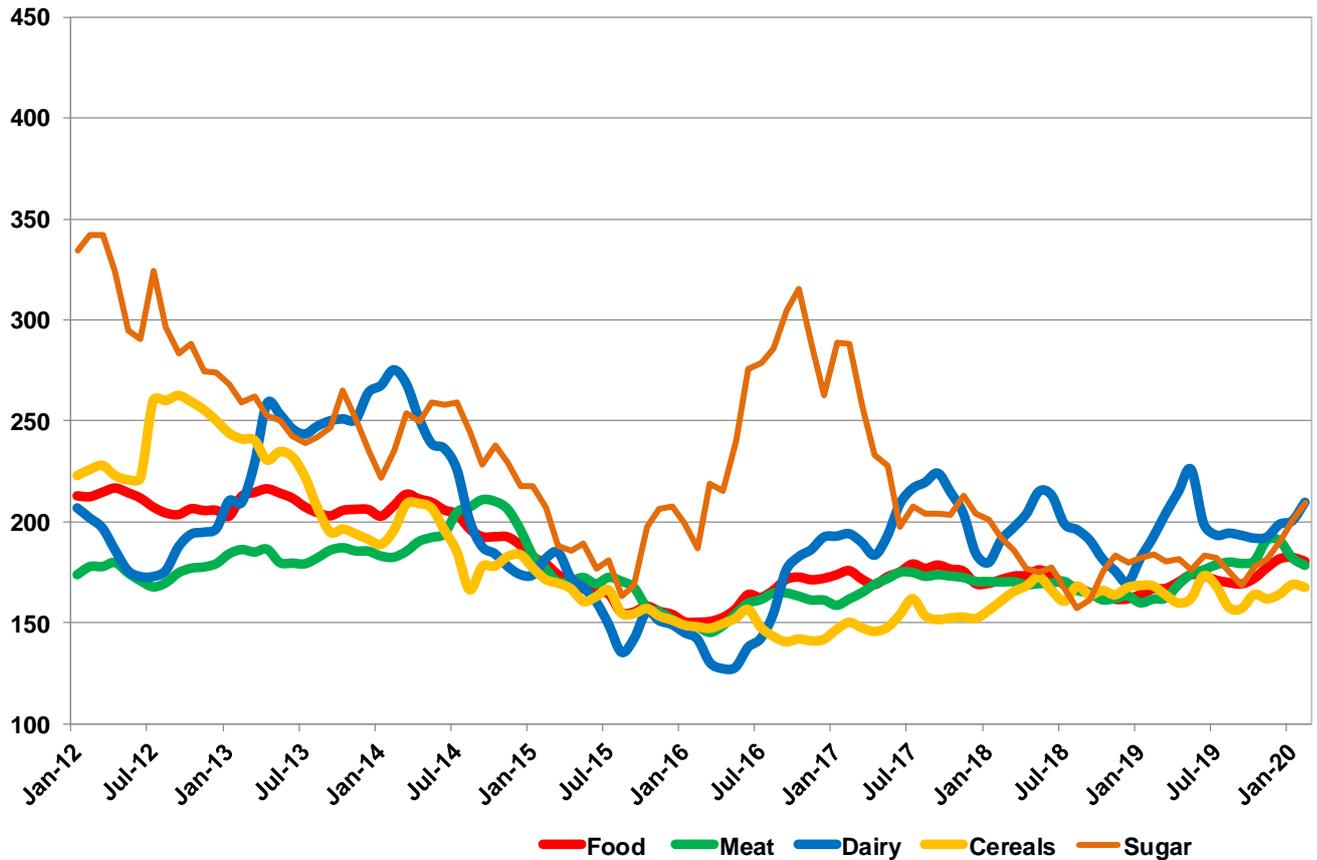


Figure 12 Monthly FAO food price indexes

Source: FAO food price index

The Global Dairy Trade platform is an online auction through which large volumes of dairy products can be sold or bought. There are two trading events per month where people across the globe can enter bids or offers.

Figure 13 shows the movement of the Global Dairy Trade (GDT) price index inclusive of December 2019. There is a clear price support level at 900 index points and a price resistance level at 1100 index points. The February 2020 price slowed down further, once again confirming the 1100 resistance level, with the price currently in no man's land.

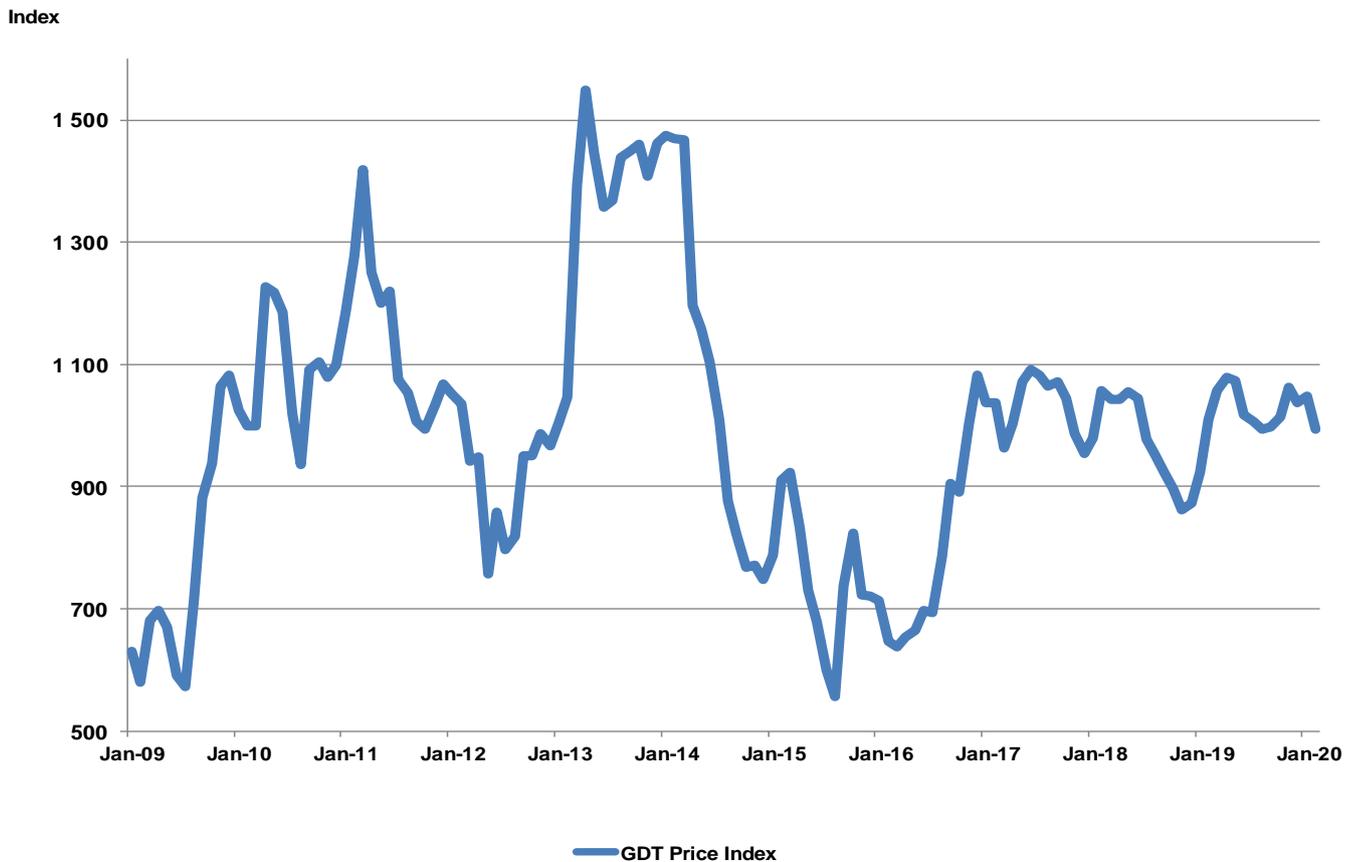


Figure 13 Global dairy trade-weighted price index

Source: Global dairy trade

Figure 14 shows international prices for milk powders, butter and cheddar cheese as reported by USDA in Rand/ton inclusive of February 2020. The upward trend for dairy product prices since the beginning of 2019 was led by cheese with butter providing further momentum.

In Rand terms all prices increased from Jan 2019 to February 2020 with butter up by 10%, SMP 38%, cheese 31% and FMP by 24%.

In USD terms over the same period butter is up by 2%, SMP 28%, cheese 21% and FMP 15%.

The main reasons for the hike in international prices is limited export availability, which is the result of adverse climatic conditions in New Zealand and Australia on the one hand and a cycle of low producer price in the main exporting countries during 2018/19.

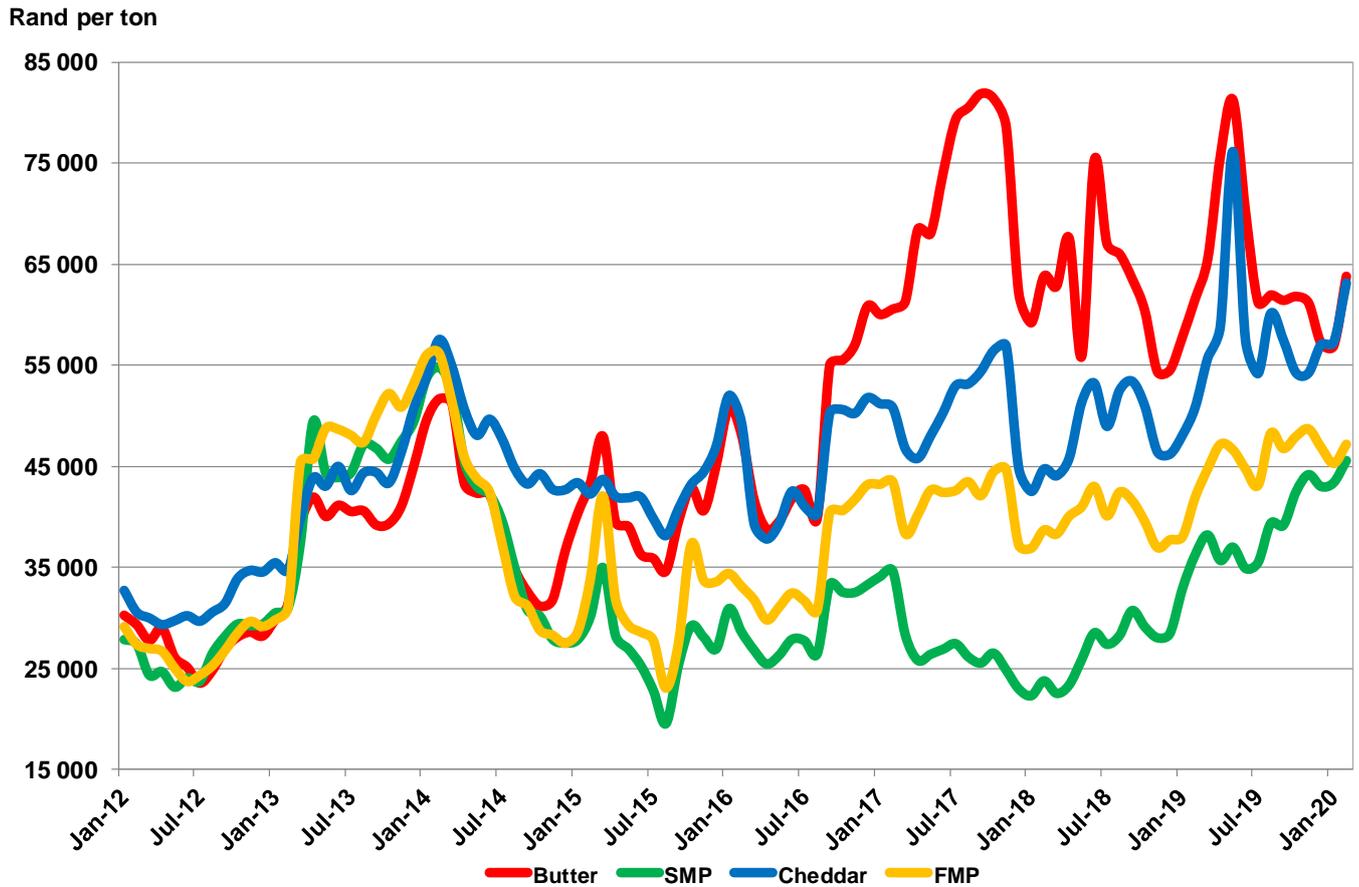


Figure 14 International dairy product prices (Rand/ton)

Source: USDA, SA Reserve Bank

1.12 Import parity and producer prices

The MPO's benchmark import parity is based on the published USDA prices, SA Rand/\$ exchange rates, standard import tariffs and import and production cost as supplied by industry sources. The calculation methodology is standardised and while import parity may differ for a specific importer, based on a specific import mix and individual cost structure, the trend indicated by the import parity index is applicable to all importers

Import parity and producer prices are reflected in Figure 15.

The current difference in import parity and SA producer price is nearly touching the same extreme levels that were experienced in January 2014.

Rand per litre

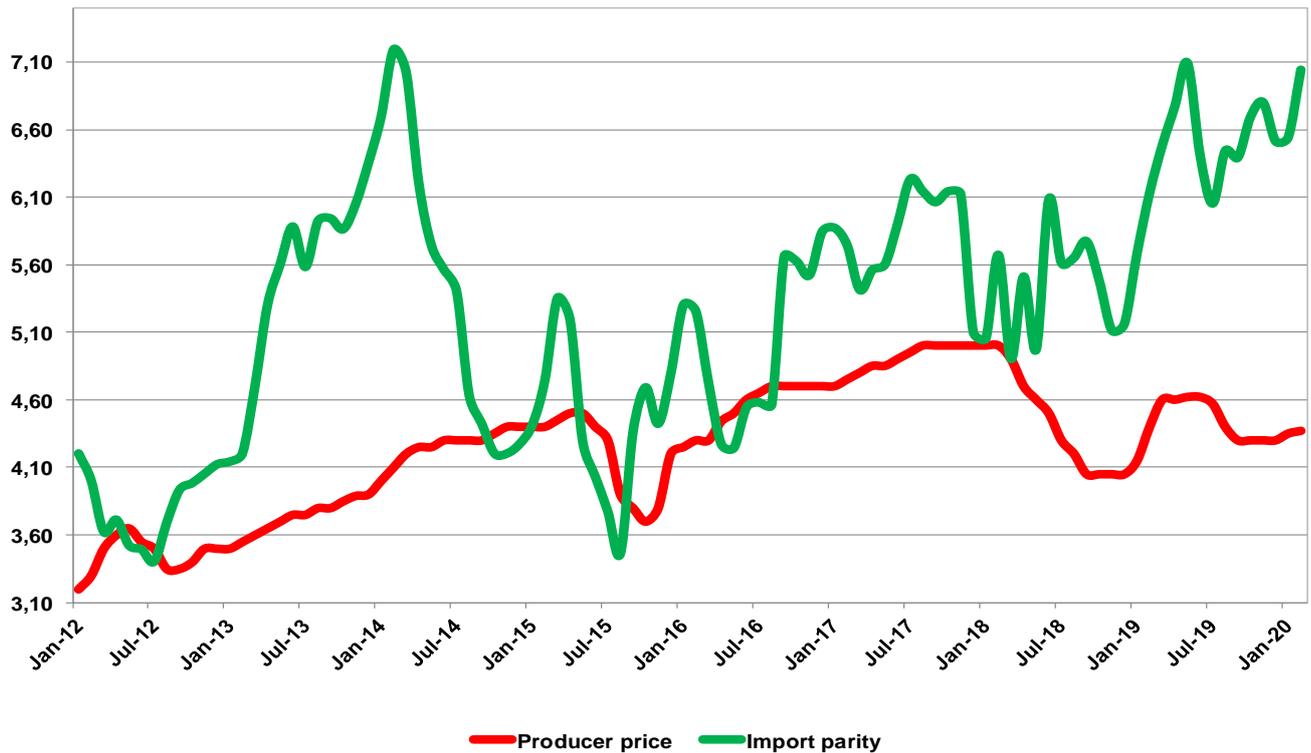


Figure 15 Monthly producer and import parity prices

Source: MPO calculations

Import parity and producer prices

Import parity at or below average producer prices implies that processors can import dairy products at current international prices at a lower price per litre than they have to pay local producers. An importing processor will still have to service the fixed cost on infrastructure and an importing retailer has to pay for packaging and manage returns.

2. Changes in cumulative unprocessed milk production in the major dairy exporting countries

Changes (%) in cumulative unprocessed milk production in the major dairy exporting countries and South Africa 2015 – 2019 (2019 only first 11 months). SA first 12 months, last month preliminary.

	2015	2016	2017	2018	2019
USA	1.2	1.6	1.7	1.1	0.3
EU	2.1	0.2	2.1	1.4	0.4
AUS	2.2	-6.9	0	0.9	-7.3
NZ	-1.4	-2.0	1.7	1.3	-0.8
URU	-2.0	-10.4	7.6	5.7	-4.0
ARG	1.5	-14.4	-1.6	6.4	-2.3
ZA	6.4	-0.5	3.0	5.0	0.23

Milk production at farm level is down for all the major exporting countries. This provides illumination on the strong increases in international dairy product prices for 2019 and the current nervousness on the Global Dairy Trade Index.

3. Economic overview

3.1 International economic outlook

Global growth is projected to rise from an estimated 2.9 percent in 2019 to 3.3 percent in 2020 and 3.4 percent for 2021—a downward revision of 0.1 percentage point for 2019 and 2020 and 0.2 for 2021 compared to those in the October World Economic Outlook (WEO). The downward revision primarily reflects negative surprises to economic activity in a few emerging market economies, notably India, which led to a reassessment of growth prospects over the next two years. In a few cases, this reassessment also reflects the impact of increased social unrest.

The above changes reflects the downward adjustments as reported in the January 2020 IMF WEO. One can expect a further downward adjustment for all the economies in the February 2020 report as a result of the deepening Covid-19 effect.

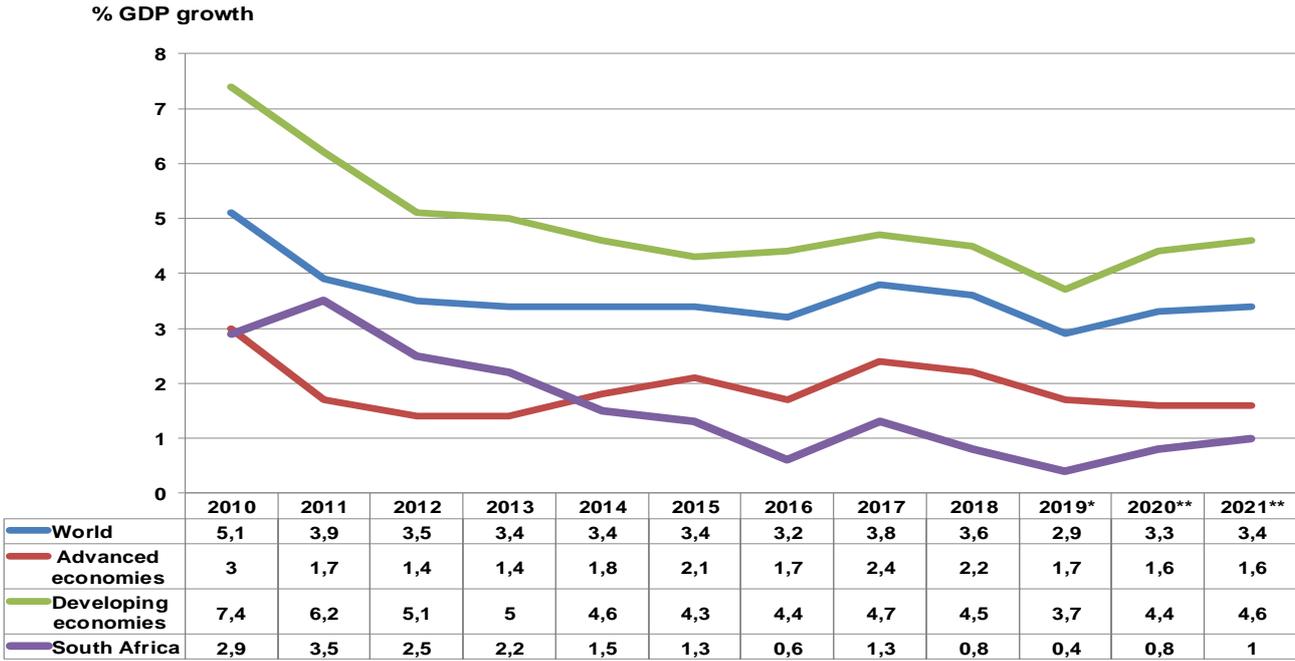


Figure 16 International economic growth and estimated growth

* Estimate
 ** Projection

Source: IMF WEO Jan 2020

3.2 South African economy

3.2.1 Economic activity and growth

Indicators of economic activity are provided by the SA Reserve Bank in the form of a co-incident, leading and lagging indicator. The monthly movement of the leading and co-incident indicator of economic activity is reflected in Figure 17. The leading indicator signals future economic activity while the co-incident indicator reflects what is happening now in the economy.

Figure 18 shows the quarterly growth rate of the SA gross domestic product. The SA economy contracted with 3.2% in the first quarter of 2019, in the second quarter a growth rate of 3.1% was achieved, in the third quarter it contracted again with 0.8% and in the last quarter of 2019 the economy contracted with 1.4%. The consecutive quarterly contractions placed SA in a technical recession. The SA economy registered a marginal growth rate of 0.2% for the full year 2019 which is the lowest over the past 10 years. The magnitude of the decay in government departments and parastatals has been under estimated and will take longer to fix. In the fourth quarter of 2019 agriculture contracted by 7.6%, manufacturing 1.8%, construction 5.9%, electricity 4.0%, trade 3.8%, the government 0.4% and transport 7.2%. Mining and financial services grew respectively with 1.8% and 2.7%. The growth rate of the SA economy has been around 1% since 2015 and that is the elephant in the room. The main focus of the Minister of Finance in the 2020 budget speech on reducing government expenditure provides insight in the understanding of poor status of the SA economy. However, one needs to point out that although it is a step in the right direction the only way to stop the unsustainable growth in government debt as a percentage Gross Domestic Product (GDP) is through high levels of economic growth.

In a free market economy where supply and demand reflects the scarcity of the different production factors the entrepreneur is the link in optimising these factors and creating competition. As soon as government's share of the economy starts to get too big the role of the entrepreneur is suppressed with less optimisation and competition.

If economic growth is realised as the sweet spot to produce a thriving country the role of government in the economy should reduce while looking after infrastructure, the rule of law, education system, trade agreements, public health system and functioning government departments at all levels of government. Furthermore growth policies or programmes should guard against all sorts of prefixes and warped economic concepts. "Inclusive economic growth" should be "economic growth" There is wide appreciation of the need to alleviate poverty and to expand wealth but first get the formula for economic growth in the SA context right. In the process the income tax base will increase leading to increased income for the government. Once high growth levels are achieved other leavers can be employed to enhance inclusivity. Beware of being prescriptive to the entrepreneur on how to do business, with whom business can be conducted, who must be employed and the fatal encroachment of private rights. The track record of the ANC government regarding economic policy is poor begging for rethinking the current approach. Unfortunately the new leadership inherited a ship full of breaches and holes and to top it a Covid-19 pandemic.

Indicators of economic activity

The coincident indicator of economic activity show whether the economy is in an upwards or downwards phase of the business cycle. The current slow downwards trend indicates a slowdown in economic activity. The leading indicator shows possible changes in economic activity in future. The decreasing trend points towards still lower economic growth in future.

Index (2000 = 100)

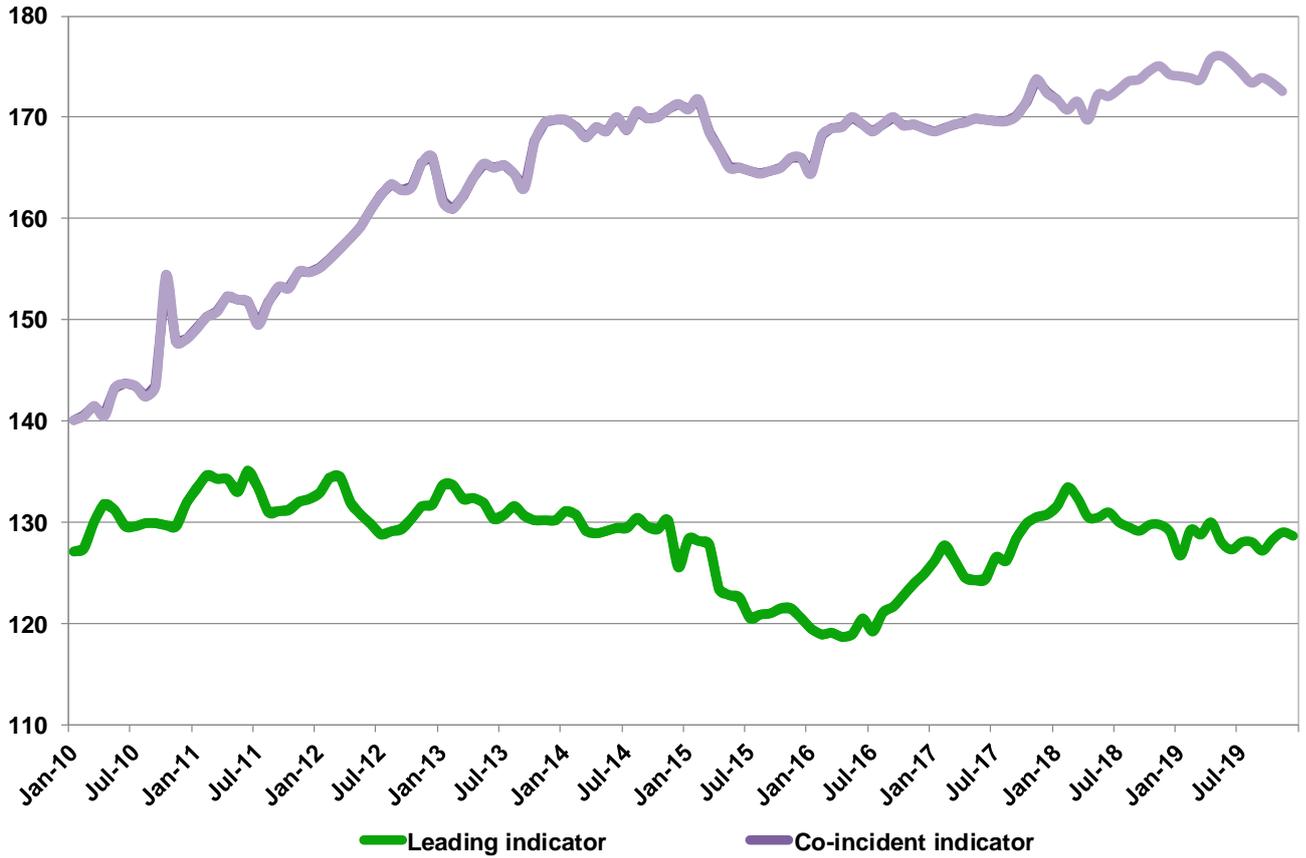


Figure 17 Leading and co-incident indicator of economic activity (Source: SARB)

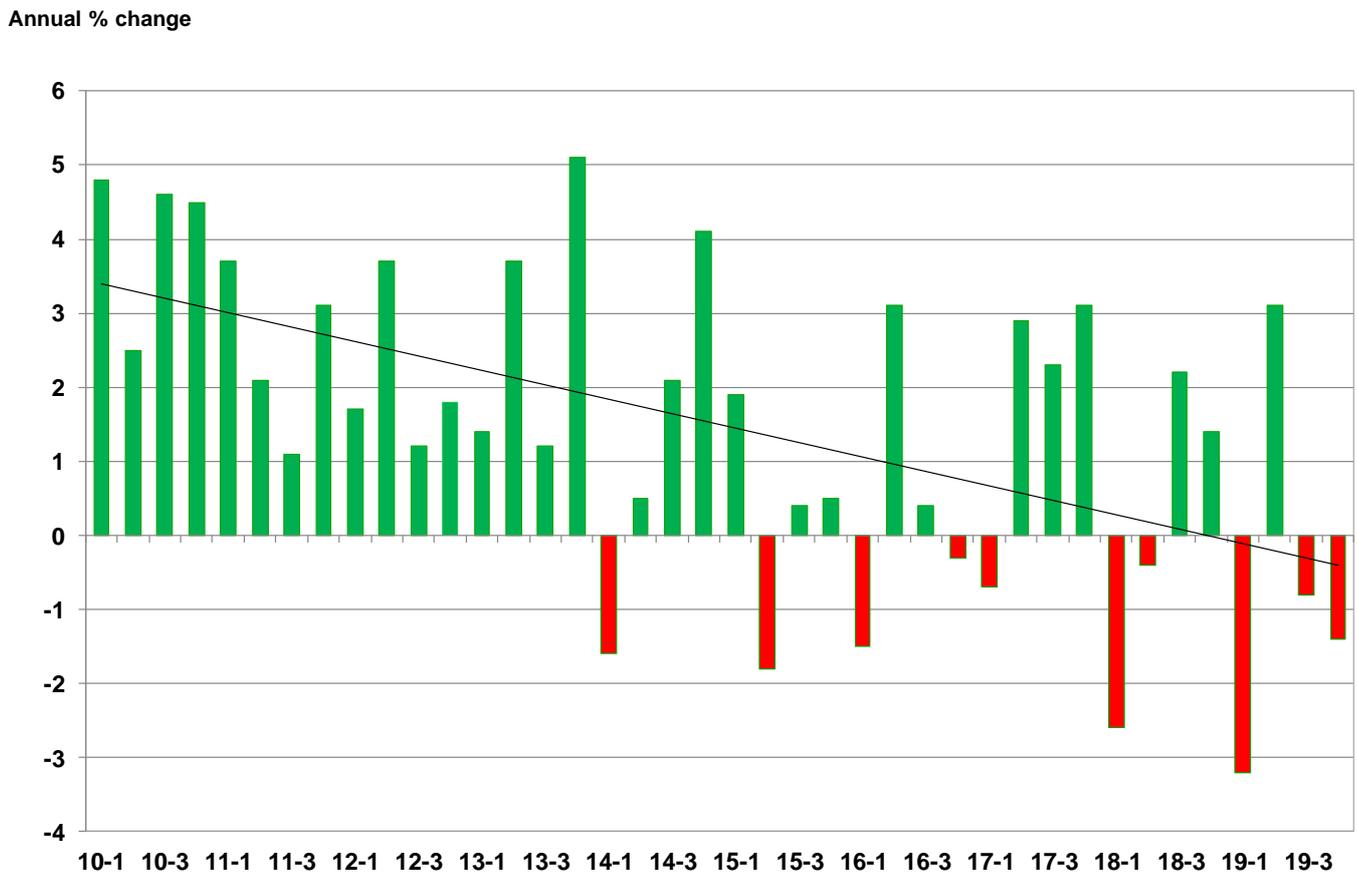


Figure 18 Quarterly change in real gross domestic product

Source: Stats SA

3.2.2 Household debt and income

Household debt at current prices as a percentage of household income has been on a steady decline since the first quarter of 2008. Household debt decreased from 87.8 to 71.3 in the third quarter of 2019.

3.2.3 Inflation

The consumer price index and monthly inflation rate are reflected in Figure 19.

Annual consumer price inflation was 4,5% in January 2020, up from 4,0% in December 2019. The consumer price index increased by 0,3% month-on-month in January 2020. The main contributors to the 4,5% annual inflation rate were food and non-alcoholic beverages; housing and utilities; transport; and miscellaneous goods and services. These are the same items that was reported last month.

Consumer price index (CPI) and inflation

The CPI is the value of a basket of goods and services on retail price level. The change in the value of this basket compared to the same period a year ago is called the rate of inflation. The Reserve Bank tries to keep the rate of inflation between 3% and 6%.

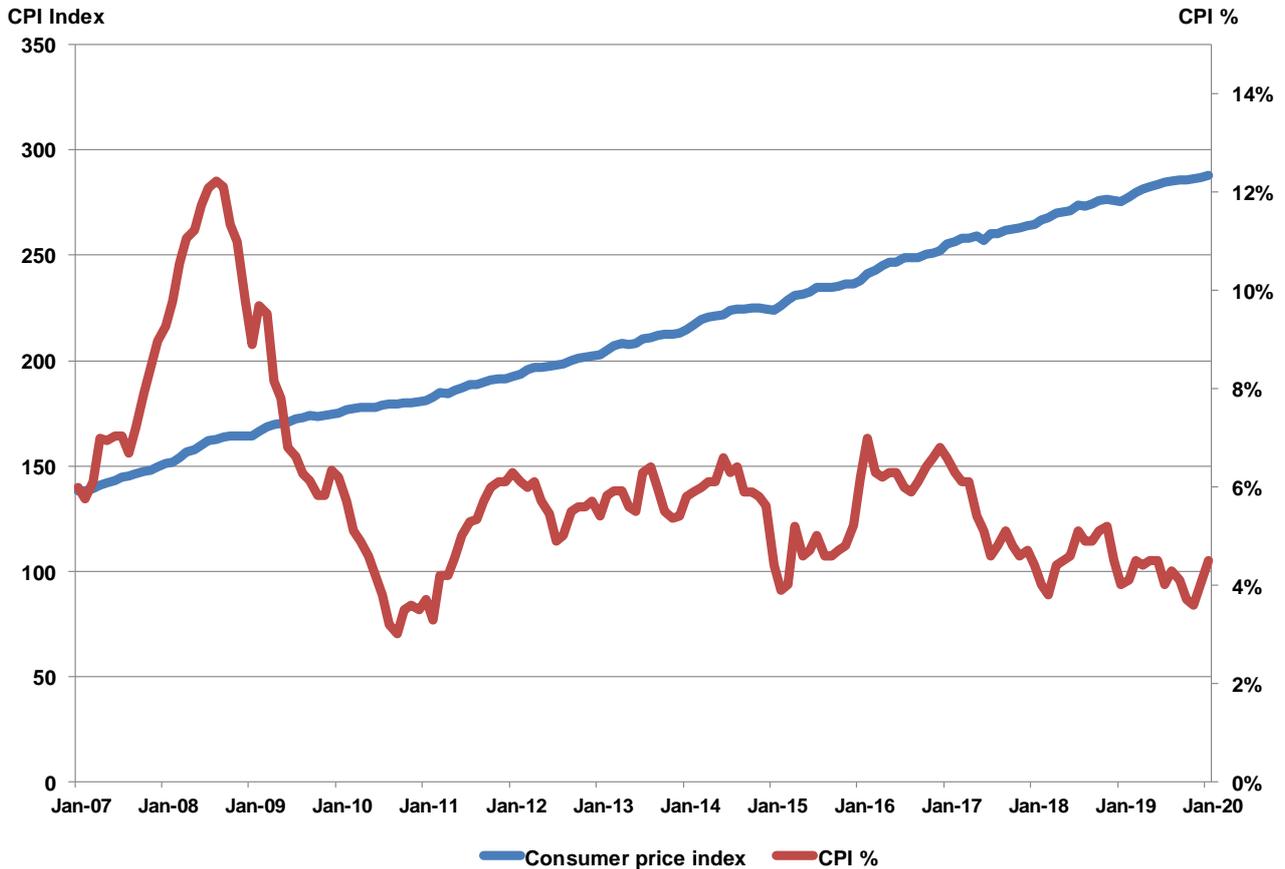


Figure 19 Consumer price index and consumer price inflation, 2007-2019

Source: Stats SA