



Dairy market trends

August 2021

Dairy Market Trends August 2021: the cost price squeeze has a death grip on milk farm economics as the average feed cost increased in August and producer prices for unprocessed milk were reduced.

Executive summary

The MPO is planning a series of market discussions with milk processors and the four large retailers to illuminate market changes regarding the cost structure on dairy farms and the distortion embedded in Free On Board imported dairy product prices that cause an uneven playing field for the South African dairy farmer. The value chain discussions will only be the first port of call. The initiative will be expanded to include all the relevant regulatory bodies and government departments in South Africa.

Cumulative unprocessed milk production, inclusive of July 2021, is down by 2.75%. The total cumulative supply of milk (in milk equivalents) for the first seven months of 2021 is 4.7% less than in 2020. Total cumulative milk supply refers to: unprocessed milk production plus imports minus exports (inclusive of sales to the other SACU countries), expressed in milk equivalents. Dairy imports, on a mass basis for the first six months of 2021 is 23% up and exports 20% up, compared to the same period in 2020. There is a disjoint in feedback from the market regarding the demand for dairy products being down. If demand is indeed down, why the surge in imports?

The recent announced by some milk processors to decrease the price paid to farmers for unprocessed milk is baseless. The only reason for the decrease is to use the spring volume growth to buy cheap milk.

The price milk processors receive in July 2021 did not reduce, it actually increased, while the retail prices moved sideways. (source: Stats SA, PPI for dairy products and CPI for milk, cheese and eggs). Milk processors paying farmers less than R5,80 is unreasonable and they are using their position in the market to push the producer price down. Unprocessed milk prices in South Africa has entered a new price regime and farmers need to support processors that handle the current situation sensibly and responsibly.

The average price for unprocessed milk over the first six months of 2021 in the EU (excluding the U.K.) was R6.20. The price in Poland over the same period was R5.80 (source: European Commission, June 2021 prices are estimates, prices of raw milk at real fat and protein content).

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 July 2021 is estimated at 248 million litres, 1.13% less than in July 2020. Cumulative unprocessed milk production for 2021 (inclusive of July) was 1 729 million litres, indicating a decline of 2.75% in comparison to 2020.

The cost price squeeze at farmer level has a death grip on farm economics since 2018 and the July 2021 announcement by milk buyers that producer prices will decrease in August will exacerbate the cost price squeeze and negatively affect current and 2022 unprocessed milk production.

Monthly milk production is reflected in Figure 1 below.

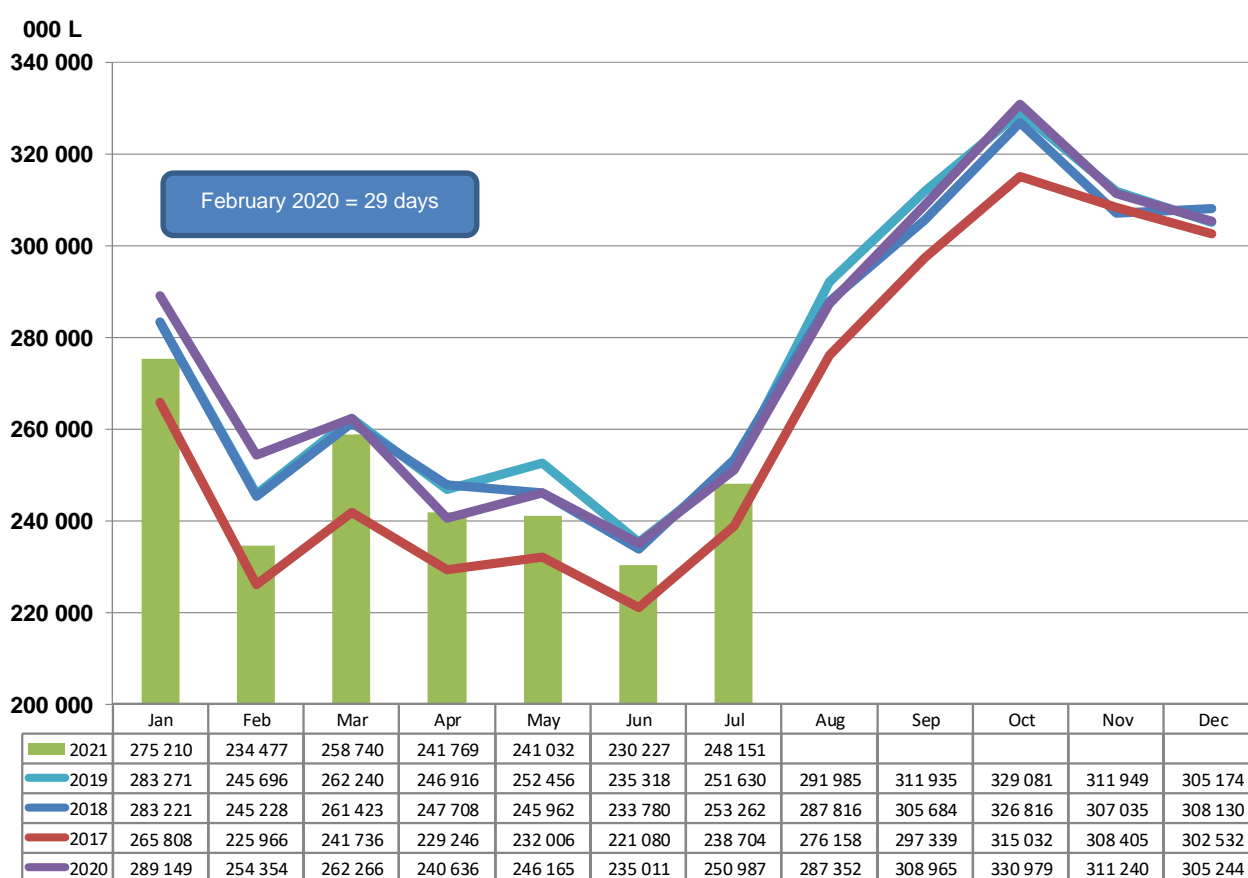


Figure 1 Monthly milk production ('000 L.).

Source: Milk SA, June and July 2021 are preliminary

1.2 Dairy imports

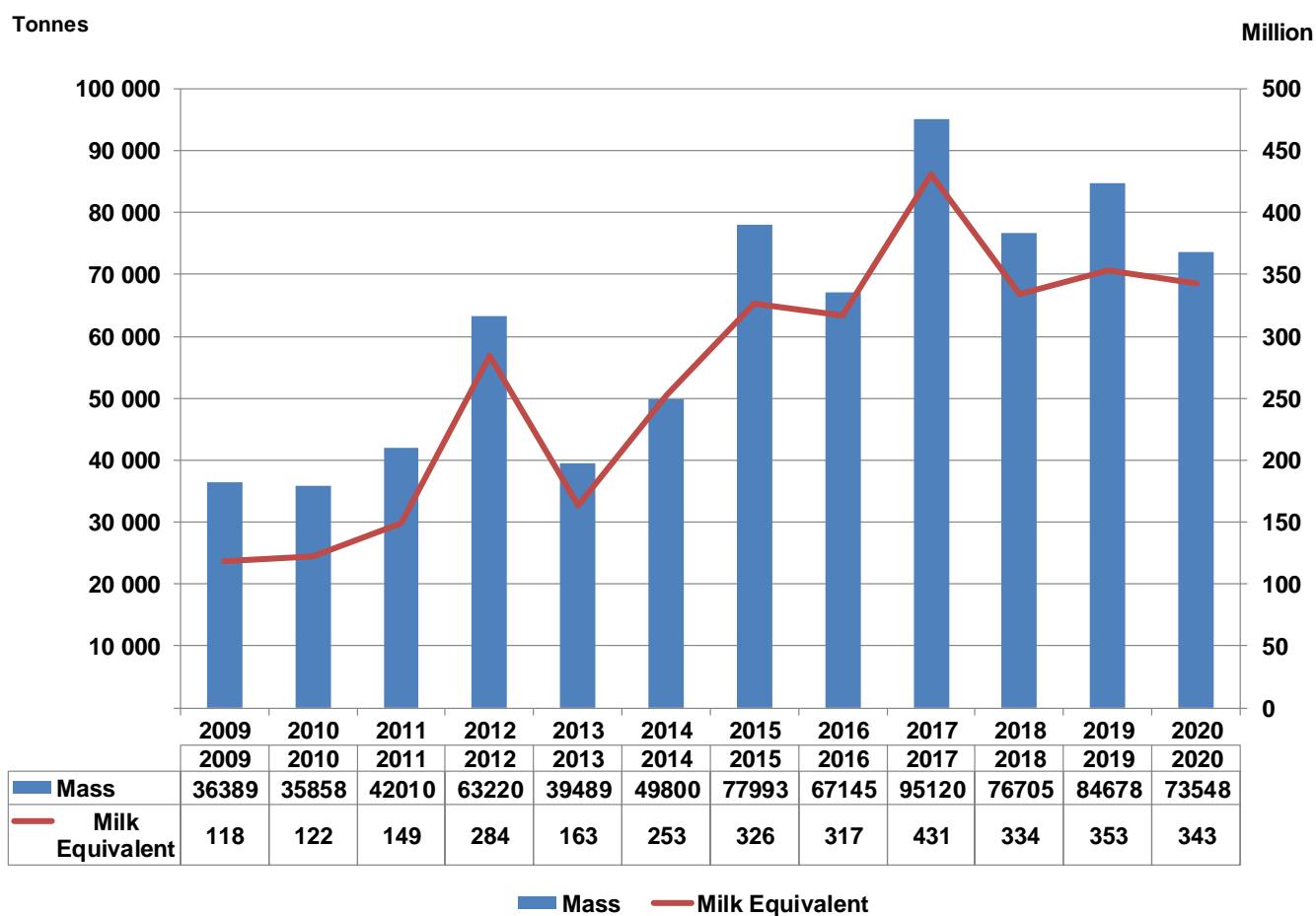


Figure 2 Annual imports, mass and milk equivalent basis, 2009-2020

Source: Agri Inspec

Figure 2 illustrates the fluctuation in dairy imports on a mass and milk equivalent basis over the past 12 years. On a mass basis, imports declined in 2020 with 13.1% compared to 2019. On a milk equivalent basis, imports declined in 2020 with 2,8% compared to 2019. The reduction in imports is mainly due to drastic increases in dairy commodity prices in South African Rand (ZAR) terms during the second and third quarter of 2020. The depreciation of the ZAR was in reaction to the worldwide pandemic, specifically during the initial stages.

Figure 3 illustrates monthly cumulative dairy imports on a milk equivalent basis.

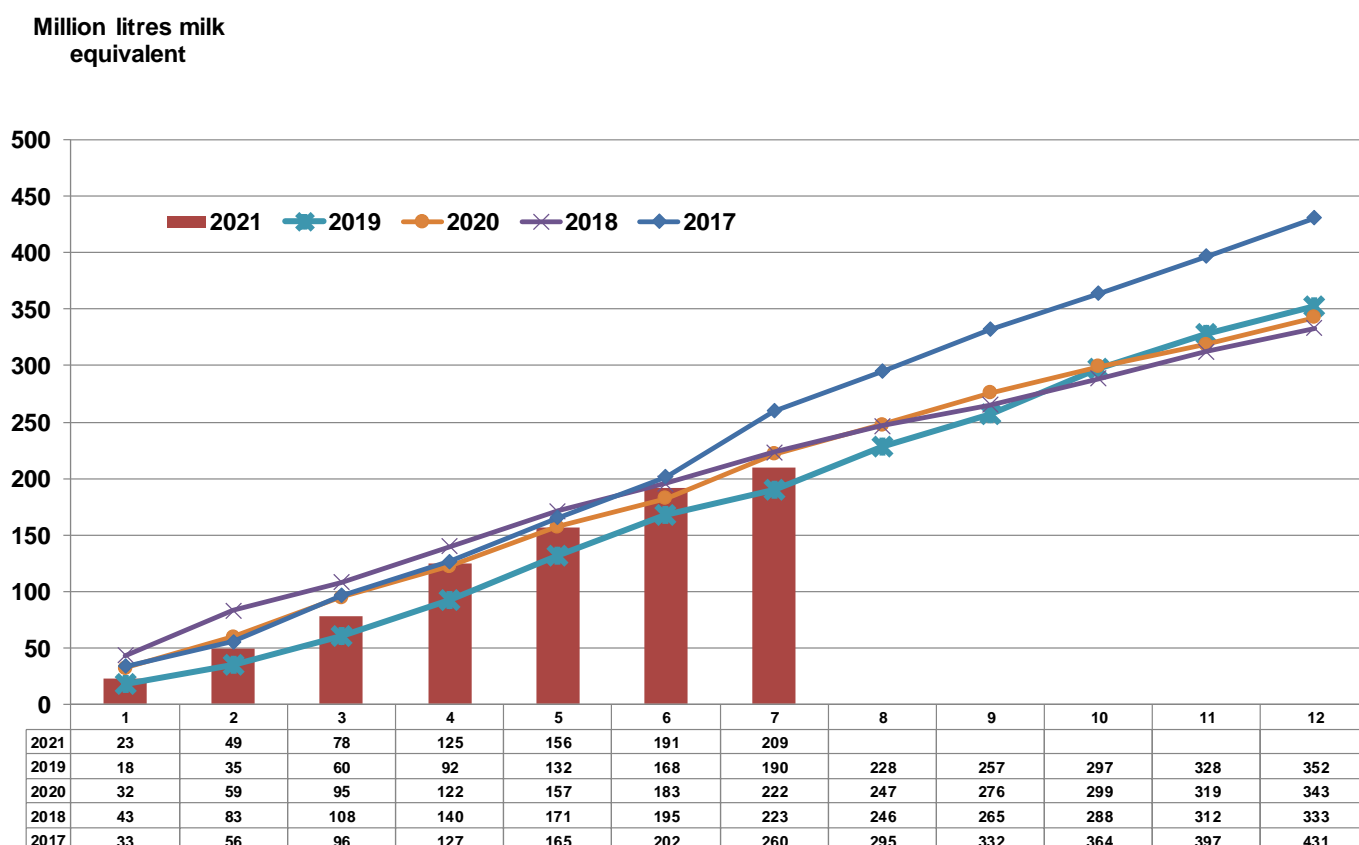


Figure 3 Monthly cumulative imports, (Mil. L.) milk equivalent basis

Source: Agri Inspec

1.3 Dairy exports (inclusive of sales to the BLNE countries)

Monthly cumulative exports on a milk equivalent basis are reflected in Figure 4 below. Exports in 2020 recorded an all-time high record, where SA exported 460 million litres of milk. This is a feather in the cap of the dairy value chain and affected government departments – the route to market was maintained despite the “lockdown”-restrictions in South Africa and in our trading partners.

Furthermore, it is an indication that export markets are well looked after by the SA exporters, that the markets are satisfied with the product range and quality and that untapped potential exists in the export market.

The positive export story continues into 2021. Cumulative exports for the first seven months increased with 8% in comparison to same period in 2020.

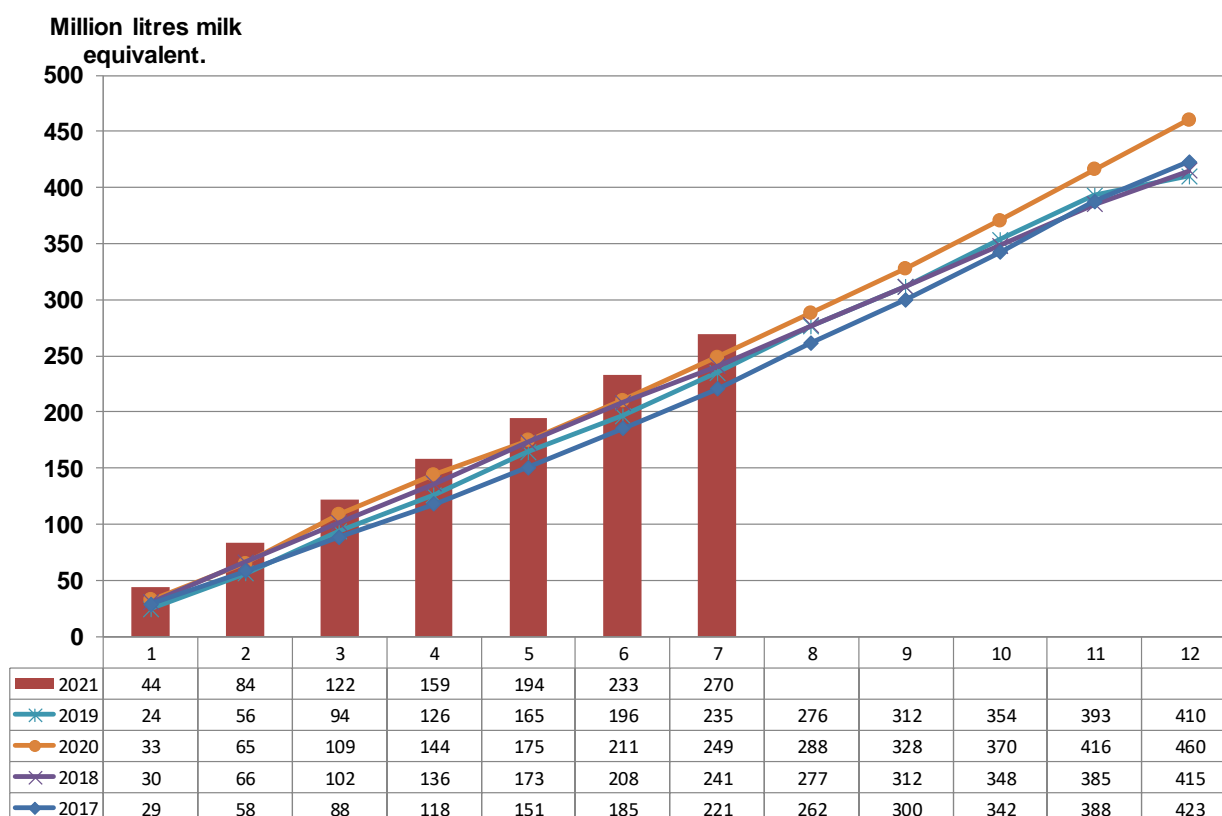


Figure 4 Monthly cumulative dairy exports (Mil. L.), milk equivalent basis

Source: Agri Inspec

1.4 Net exports (Inclusive of sales to BLNE countries)

The SA dairy industry regained its status as a net exporter of dairy products in 2018, maintained that status in 2019, 2020 and for the first seven months in 2021. Cumulative net exports (total exports plus sales to BLNE countries less total imports) on a milk equivalent basis are shown in Figure 5 below.

Mil. L. ME

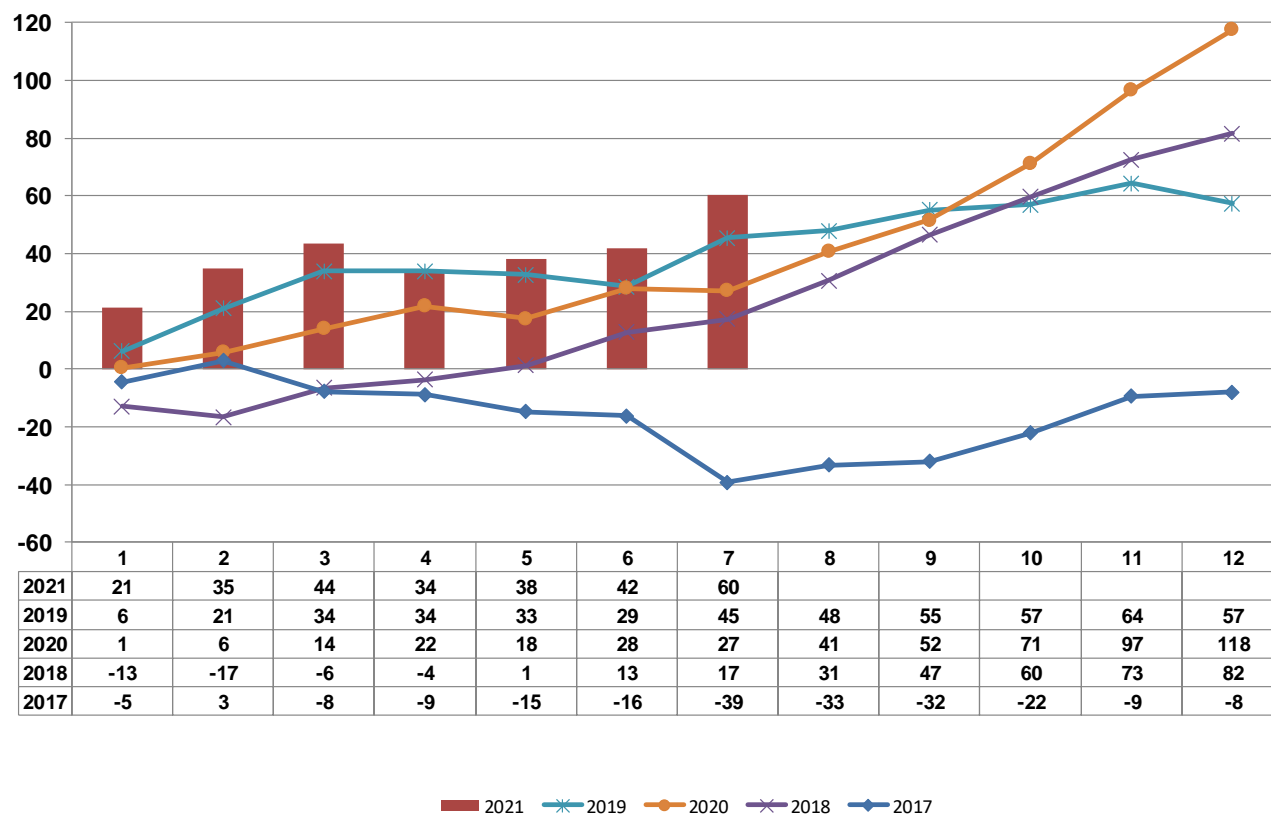


Figure 5 Cumulative net exports, milk equivalent basis (Mil. L.)

Source: Agri Inspec

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 BLNE countries less total imports) is reflected in Figure 6. The total cumulative supply of milk (milk equivalents) for the first seven months of 2021 is 4.7% less than in 2020.

Mil. Litres

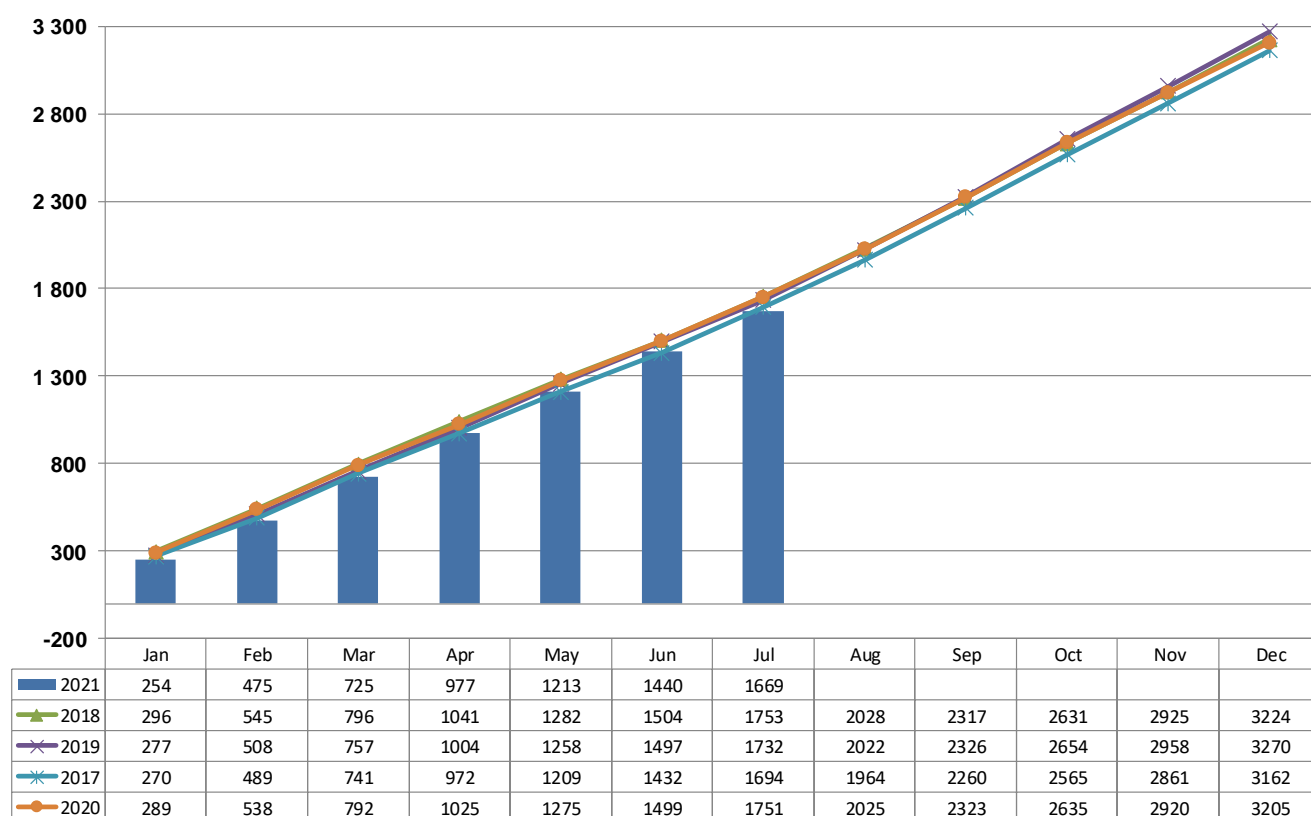


Figure 6 Total Cumulative monthly milk supply

Source: MPO calculation

1.6 Milk demand

Table 1 contains information regarding the change in retail sales quantities for specific dairy products. Changes in the retail price of dairy products impact on sales quantities.

In the year which ended in March 2021, the retail sales quantities of two of the nine dairy products were from 8.6 and 8.8 percent lower than in the year which ended in March 2020, while the retail sales quantities of seven dairy products were from 1.9 to 13.8 percent higher than in the year that ended in March 2020.

Comparing 2021 sales quantities to 2020 sales need to be interpreted while taking cognisance of the distortion that occurred due to the hard lockdown and various further stages of lockdowns due to the pandemic.

TABLE 1: PERCENTAGE CHANGE IN RETAIL SALES QUANTITIES FOR SPECIFIC DAIRY PRODUCTS

PRODUCT	Sales in the month of March 2021 versus the sales in the month of March 2020	Sales in the 3 months from January 2021 to March 2021 versus the sales in the 3 months from January 2020 to March 2020	Sales in the 6 months from October 2020 to March 2021 versus the sales in the 6 months from October 2019 to March 2020	Sales in the 9 months from July 2020 to March 2021 versus the sales in the 9 months from July 2019 to March 2020	Sales in the 12 months from April 2020 to March 2021 versus the sales in the 12 months from April 2019 to March 2020
	percent		percent		percent
Fresh Milk	-11.8	-8.2	-8.7	-8.8	-8.8
UHT milk	-18.8	-4.8	-0.2	2.6	5.5
Flavoured milk	2.2	0.3	-3.6	-6.8	-8.6
Yoghurt	-5.9	-0.9	2.5	3.9	7.2
Maas	11.4	3.4	-0.1	0.7	2.5
Pre-packaged cheese	-6.6	-1.0	4.3	6.1	9.9
Cream cheese	-6.9	-1.3	-0.9	-0.8	1.9
Butter	-3.4	8.8	5.1	7.4	10.2
Cream	3.9	11.4	9.5	11.1	13.8

Source: Nielsen supplied by Sampro

Table 2 contains information regarding the changes in the average retail prices of specific dairy products.

In the year which ended in March 2021, the retail sales prices of eight of the nine dairy products increased with 1.2 to 12.5 percent, while that of one dairy product decreased with 3.1 percent.

TABLE 2: CHANGES IN THE AVERAGE RETAIL PRICES OF SPECIFIC DAIRY PRODUCTS

PRODUCT	March 2021 versus February 2021 (1 month ago)	March 2021 versus December 2020 (3 months ago)	March 2021 versus September 2020 (6 months ago)	March 2021 versus June 2020 (9 months ago)	March 2021 versus March 2020 (12 months ago)	March 2021 versus September 2019 (18 months ago)	March 2021 versus March 2019 (24 months ago)
	Percent	Percent	Percent	Percent	Percent	Percent	Percent
FRESH MILK	2.0	3.0	4.3	3.5	4.6	6.8	10.2
UHT MILK	-0.3	-0.3	-0.4	-0.6	4.8	3.7	11.9
FLAVOURED MILK	-0.1	-1.5	0.2	-2.0	2.0	1.6	6.3
YOGHURT	-0.1	3.5	2.7	4.8	3.5	5.0	4.5
MAAS	0.2	3.9	4.8	3.6	2.8	6.4	7.1
PRE-PACKAGED CHEESE	0.3	-1.0	1.2	0.9	3.5	5.7	5.0
CREAM CHEESE	5.7	3.8	7.7	7.5	12.5	17.0	19.3
BUTTER	0.7	-3.2	-2.0	-1.5	-3.1	6.0	6.9
CREAM	-0.04	-1.7	1.1	1.0	1.2	3.5	9.9

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**.

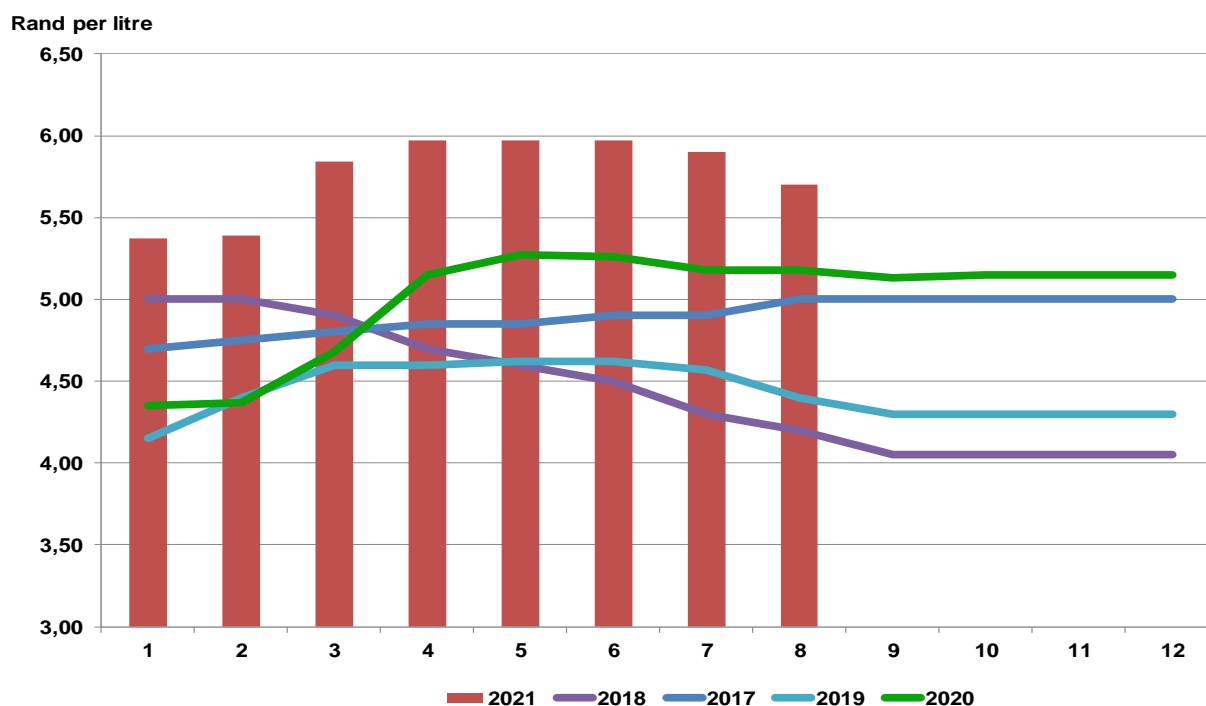


Figure 7 Monthly milk producer prices, 2017-2021

Source: July and August , preliminary, 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 farm to retail price spread is too wide and exhibiting a divergent trend. The MPO is focusing on the negative implication of this trend for dairy farmers and alerting various institutions in this regard.

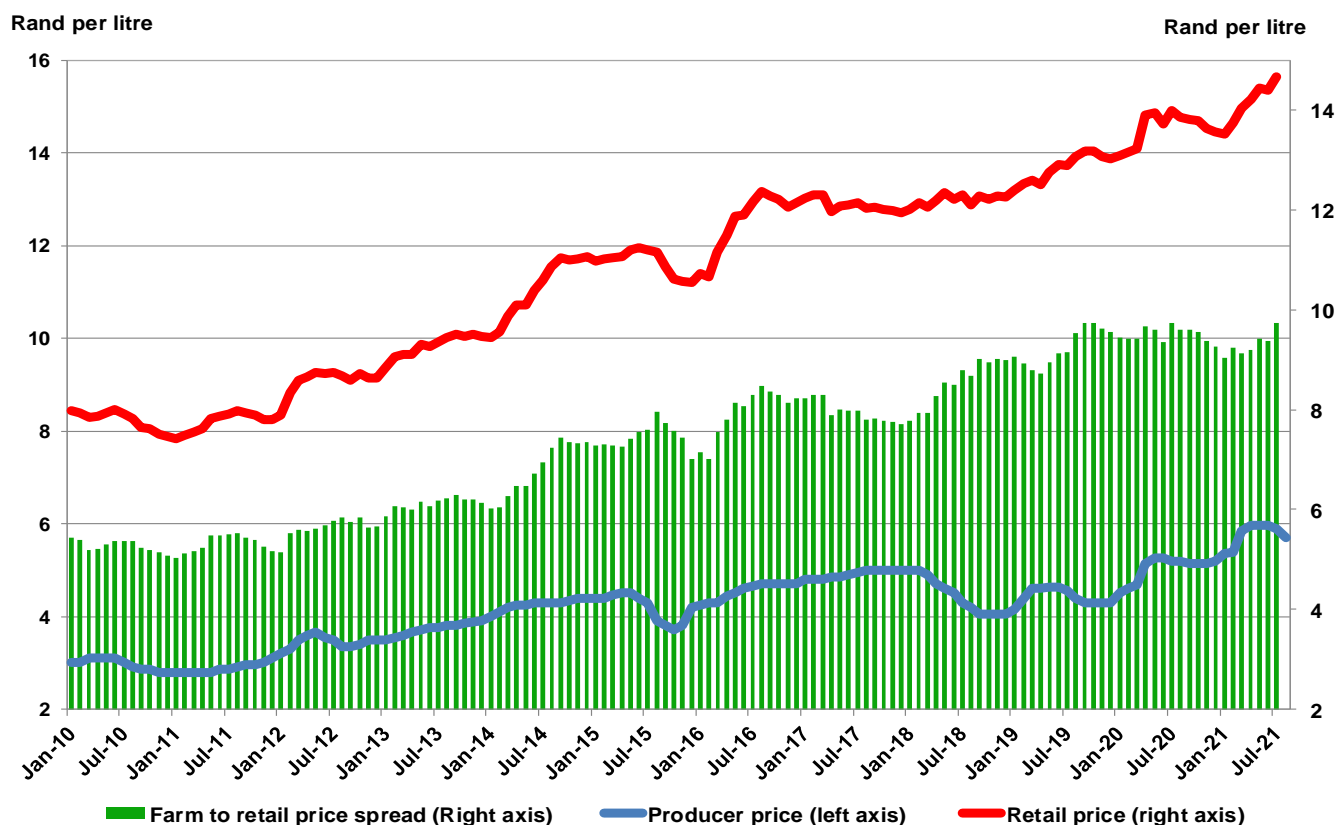


Figure 8 Monthly producer and retail prices, 2010 - 2021

Source: MPO, SANCU

1.9 Concentrate feed price

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 the producer price of unprocessed milk 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 January 2018 and continues into 2021.

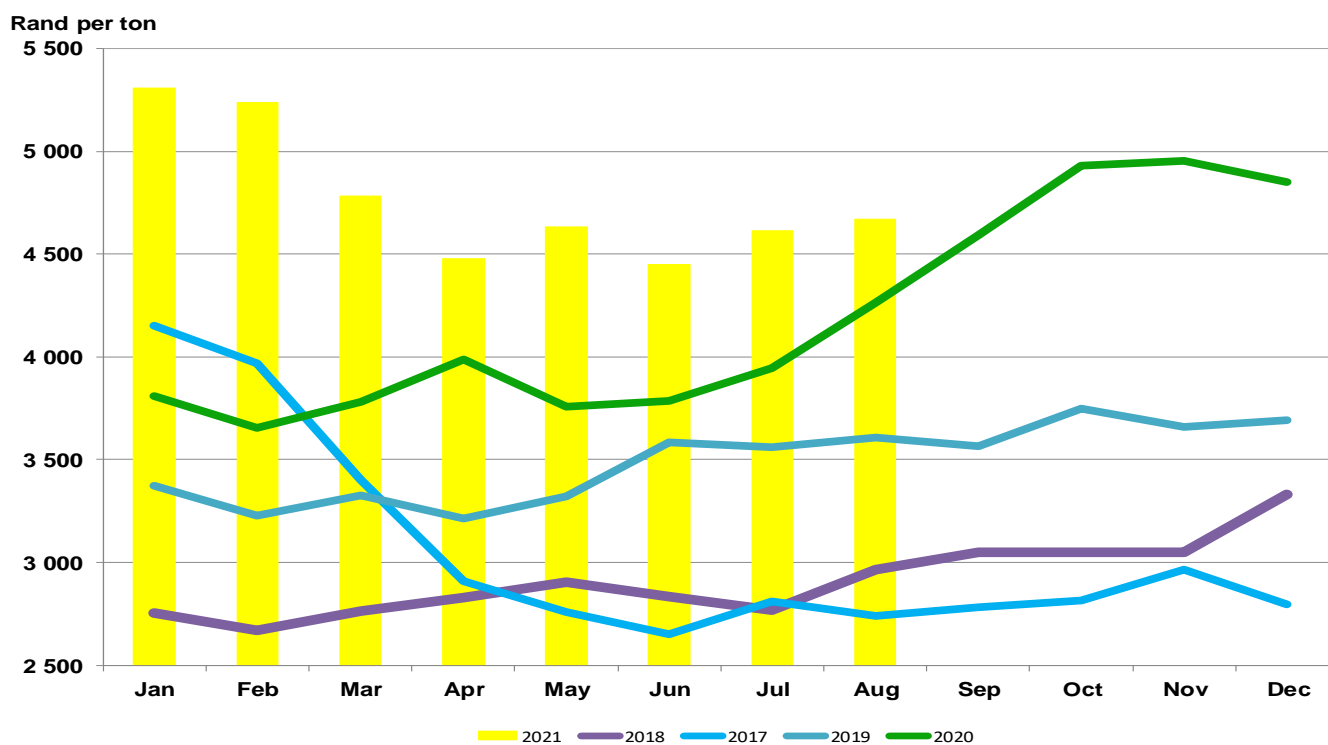


Figure 9 Calculated dairy concentrate feed prices, 2016-2021 *Source: Safex nearest month data*

The milk: concentrate feed price ratio is illustrated in figure 10. The ratio is dangerously low since August 2020. The ratio improved somewhat in April 2021 but has now again for the past two consecutive months slipped back to the 1.2:1 territory, where many dairy farmers produce at a loss.

Milk : feed price ratio

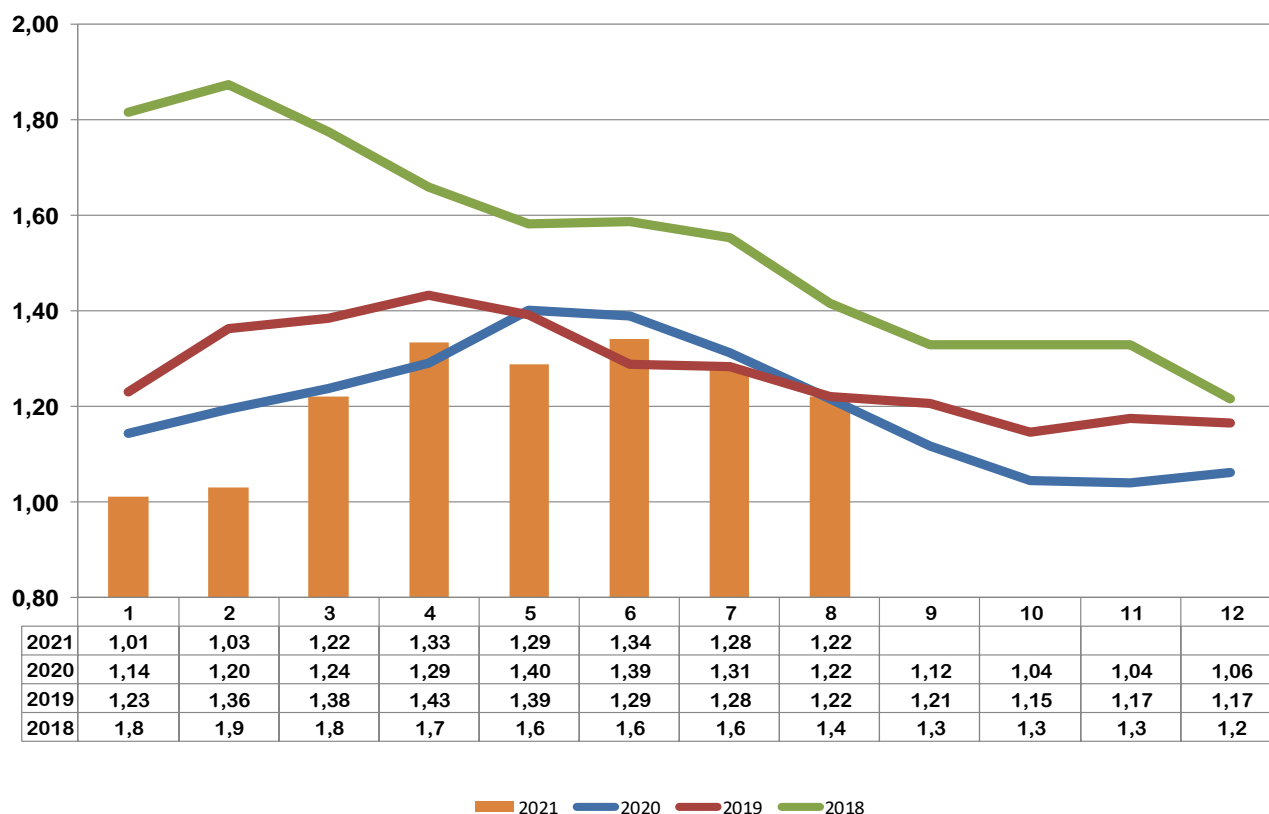
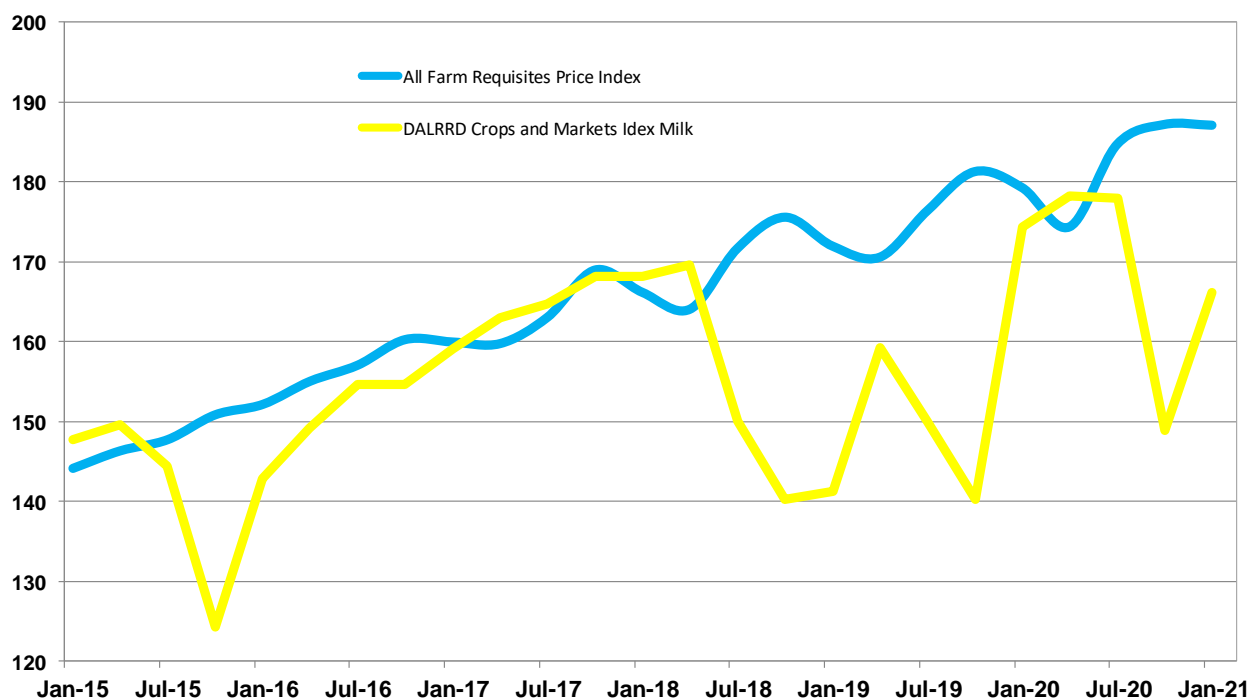


Figure 10 Milk: concentrate feed price ratio, 2018-2021 (Source: MPO calculations; July and Aug 2021 preliminary)

1.10 Input prices

The Department of Agriculture, Land Reform and Rural Development (DALRRD) 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 interaction between the cost index and the milk price explains the cost price squeeze experienced at farmer level.**

Index (2010 = 100)



Source: DALRRD, MPO calculation

Figure 11 Quarterly Farm Requisites Price Index and Producer Price Index Jan 2015 – January 2021.

1.11 International prices

The FAO Food Price Index (FFPI) averaged 127.4 points in August 2021, up 3.9 points (3.1 percent) from July and 31.5 points (32.9 percent) from the same period last year. The FFPI's rebound in August after two consecutive months of decline was led by strong gains in the sugar, vegetable oils, and cereal sub-indices.

The FAO Dairy Price Index averaged 116.0 points in August, down marginally from July but still 13.9 points (13.6 percent) above its value in the corresponding month last year. In August, international quotations for milk powders fell, reflecting the continued weakness in global import demand for spot supplies combined with seasonally rising export availabilities in Oceania during the new production season. By contrast, price quotations for cheese rose, underpinned by increased internal demand and tightened supplies in Europe, offset by a slight decline in prices in Oceania on rising production. Butter prices also rose slightly, pressured by high import demand from East Asia for near-term deliveries.

The FAO Cereal Price Index averaged 129.8 points in August, up 4.3 points (3.4 percent) from July and 30.8 points (31.1 percent) above its August 2020 level. Reduced harvest expectations in several major exporting countries pushed up world wheat prices by 11.1 points (8.8 percent) month-on-month, to 41.5 points (43.5 percent) above their level of one

year ago. By contrast, maize prices registered a slight decline of 1.3 points (0.9 percent). Improved production prospects in Argentina, the EU, and Ukraine moderated the effects of lowered production forecasts in Brazil and the United States of America. International sorghum quotations also fell in August, by 3.9 points (2.5 percent), though still up 45.5 points (43.3 percent) from the same period last year. Meanwhile, international rice prices remained on a downward trajectory in August, influenced by efforts to promote foreign sales as well as currency movements.

The FAO Meat Price Index* averaged 112.5 points in August, up slightly from July, placing the index 20.3 points (22.0 percent) above its value in the corresponding month last year. In August, international quotations for ovine and bovine meats increased, principally underpinned by high purchases, mainly by China, and constrained supplies of animals for slaughter in Oceania. Poultry meat prices also rose, reflecting solid import demand from East Asia and the Middle East and limited production expansions in some major exporting countries owing to high input costs and labour shortages.

The FAO Sugar Price Index averaged 120.1 points in August, up by 10.5 points (9.6 percent) from July, marking the fifth consecutive monthly increase and the highest level since February 2017. The latest hike in international sugar price quotations was prompted by concerns over frost damage to crops in Brazil - the world's largest sugar exporter, adding to the negative impact of prolonged dry weather conditions. Larger monthly price increases were, however, prevented by a decline in crude oil prices and a weakening of the Brazilian Real against the US dollar.

Index (2014 - 2016
= 100)

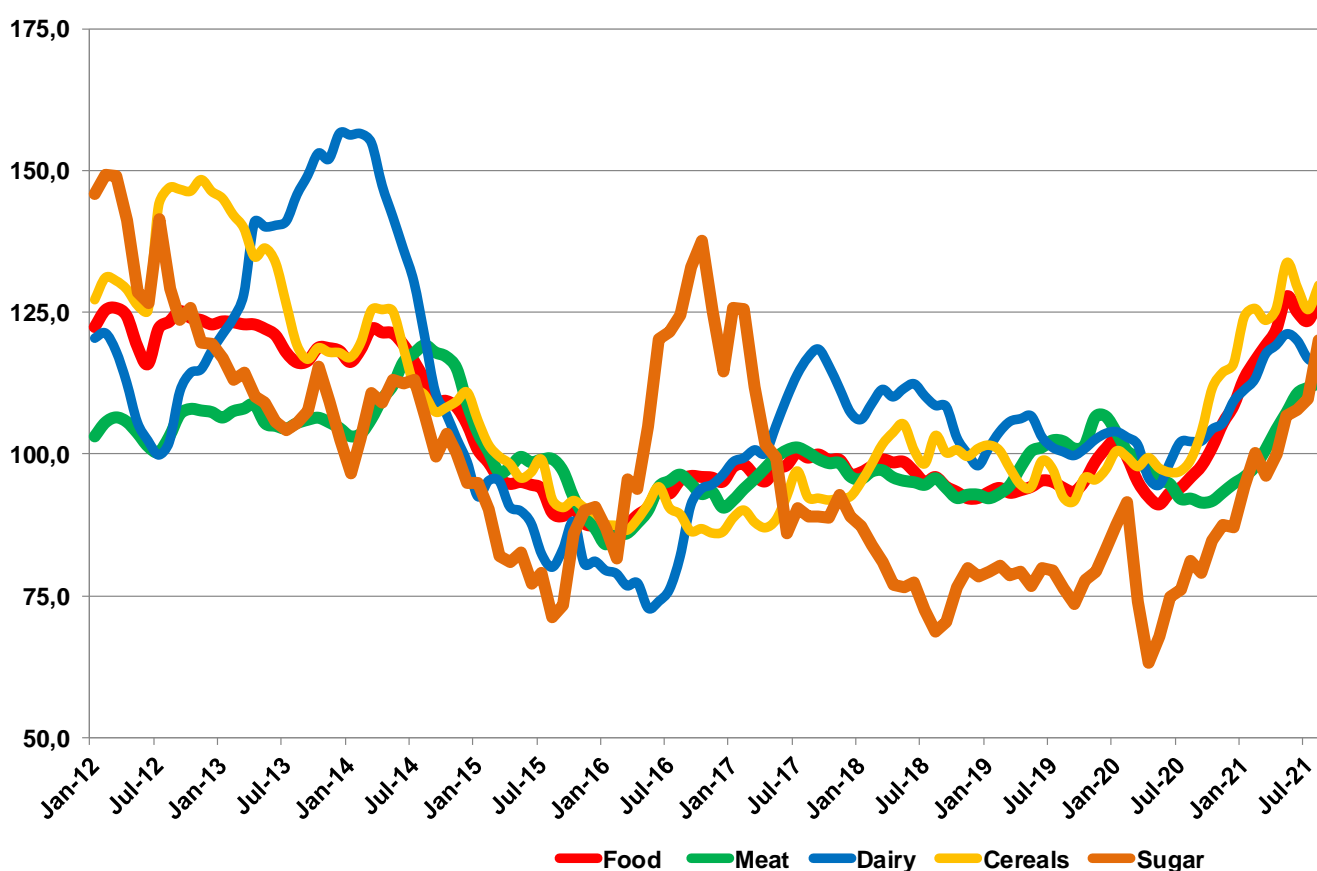


Figure 12 Monthly FAO food price indexes

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 2020. According to this index international prices (USD) are continuing to zig-zag with the index showing indication of a change in the wavelength and frequency regarding price movement, starting early in 2020. This usually indicates nervousness in the market when unknown variables are introduced which could relate to the influence of the worldwide pandemic. Both December 2020 and January 2021 registered strong upward momentum. A double break occurred in March 2021. **The 1100 and 1200 index resistance levels were sliced through, showing strong demand with limited supply.** The April index moved sideways, May retreated to below the 1300 index level and the June through August trend remained downward. It seems that global manufacturing and shipping time lost during the hard lockdown in 2020 has been partially made good with better supply and distribution causing the prices to reduce.

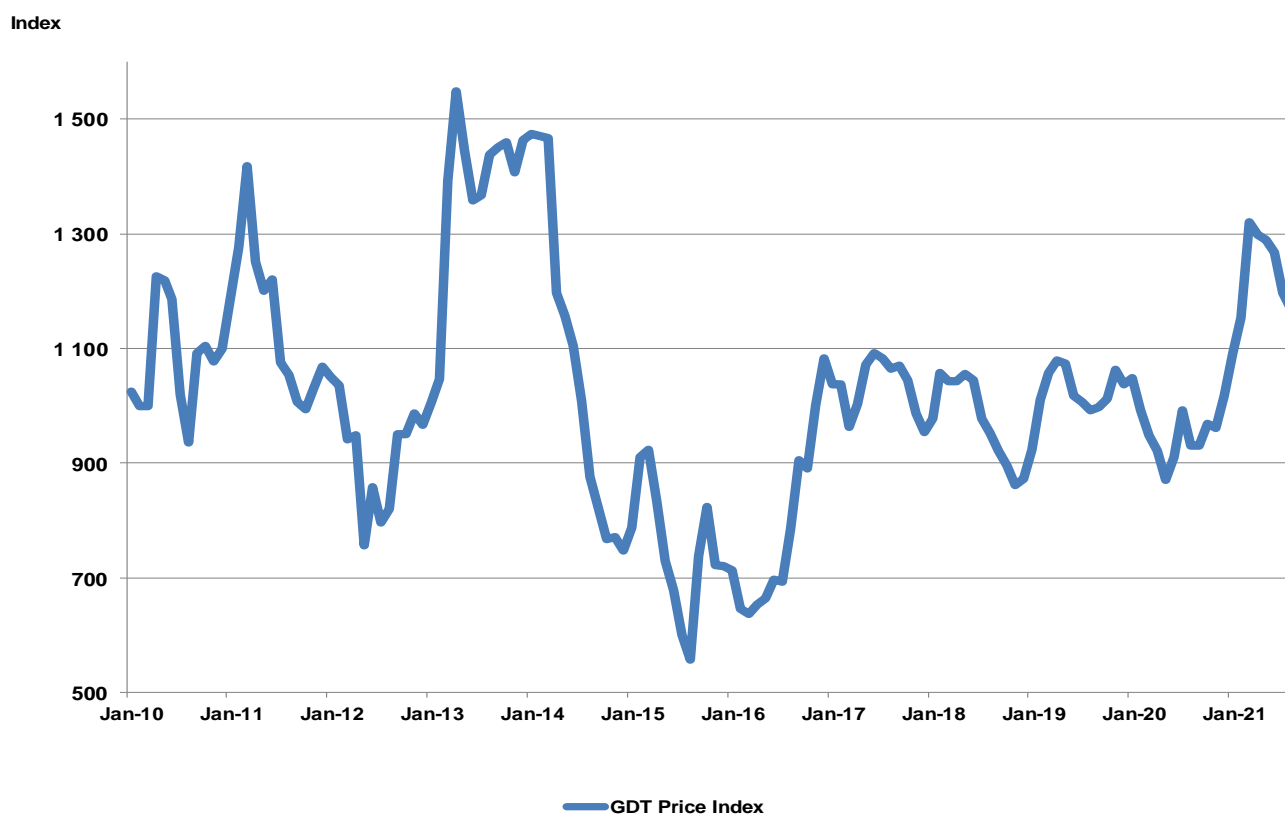


Figure 13 Global dairy trade-weighted price index

Source: Global dairy trade

Figure 14 shows international prices for milk powders, butter, and cheddar cheese as reported by the USDA converted to Rand/tonne inclusive of August 2021. In Rand terms, two of the four product prices increased from August 2020 to August 2021. Butter and whole milk powder (WMP) respectively with 15,1% and 8.4%. Skimmed milk powder (SMP) and cheddar decreased from August 2020 to August 2021 respectively with 7.2% and 2%. However, it is of note that the SMP price is 14.5% higher compared to August 2019, while cheddar is at the same level as in August 2019.

In US dollar terms all four product prices increased from August 2020 to August 2021 with butter up 28.4%, skimmed milk powder (SMP) up 3.6%, (WMP) with 21%, and cheddar cheese with 9.4%.

With the exception of cheddar, the other three product prices are in Rand and US\$ terms at noteworthy higher levels than two years ago and that will make imported products expensive.

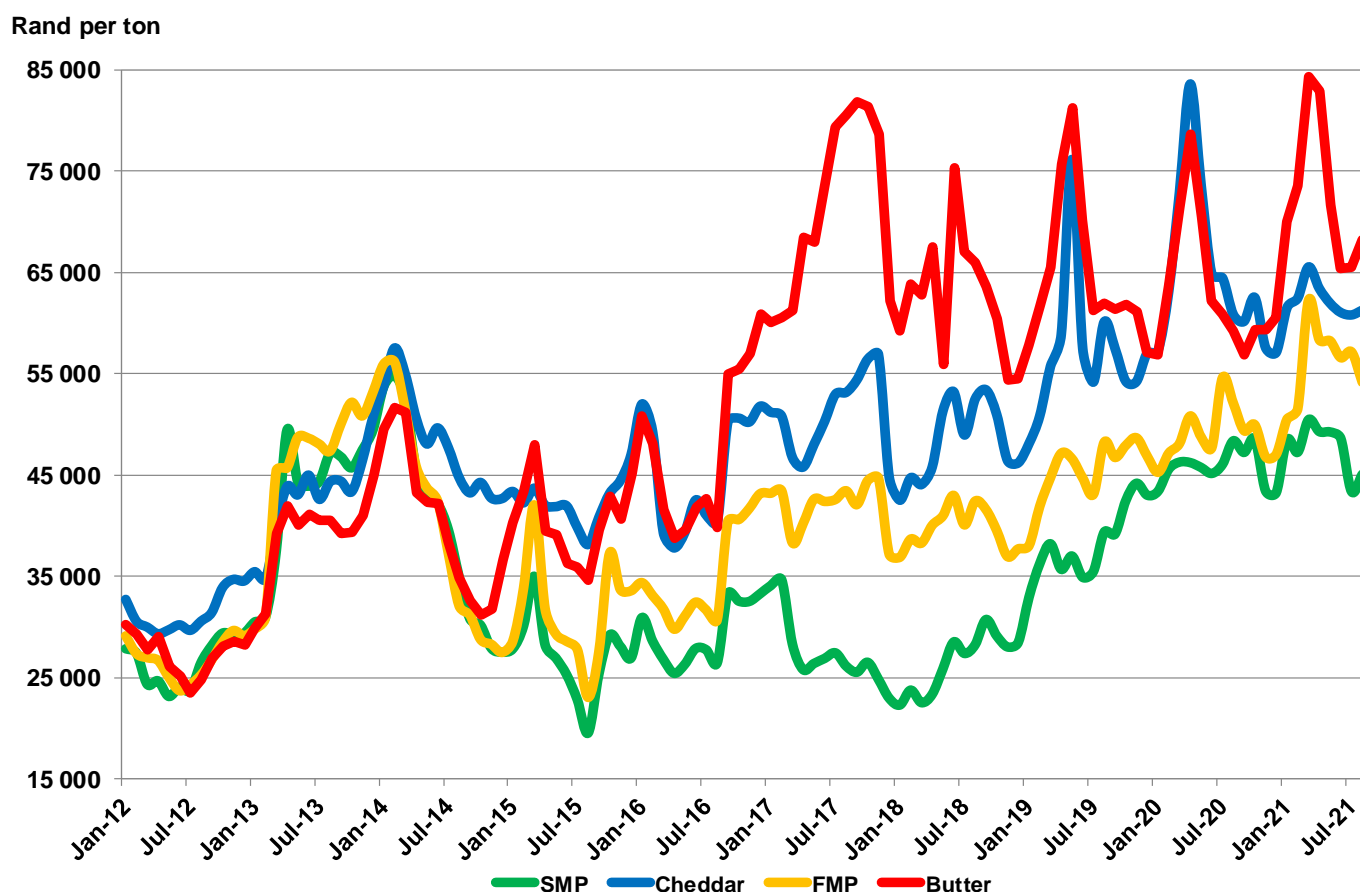


Figure 14 International dairy product prices (Rand/ton)

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.

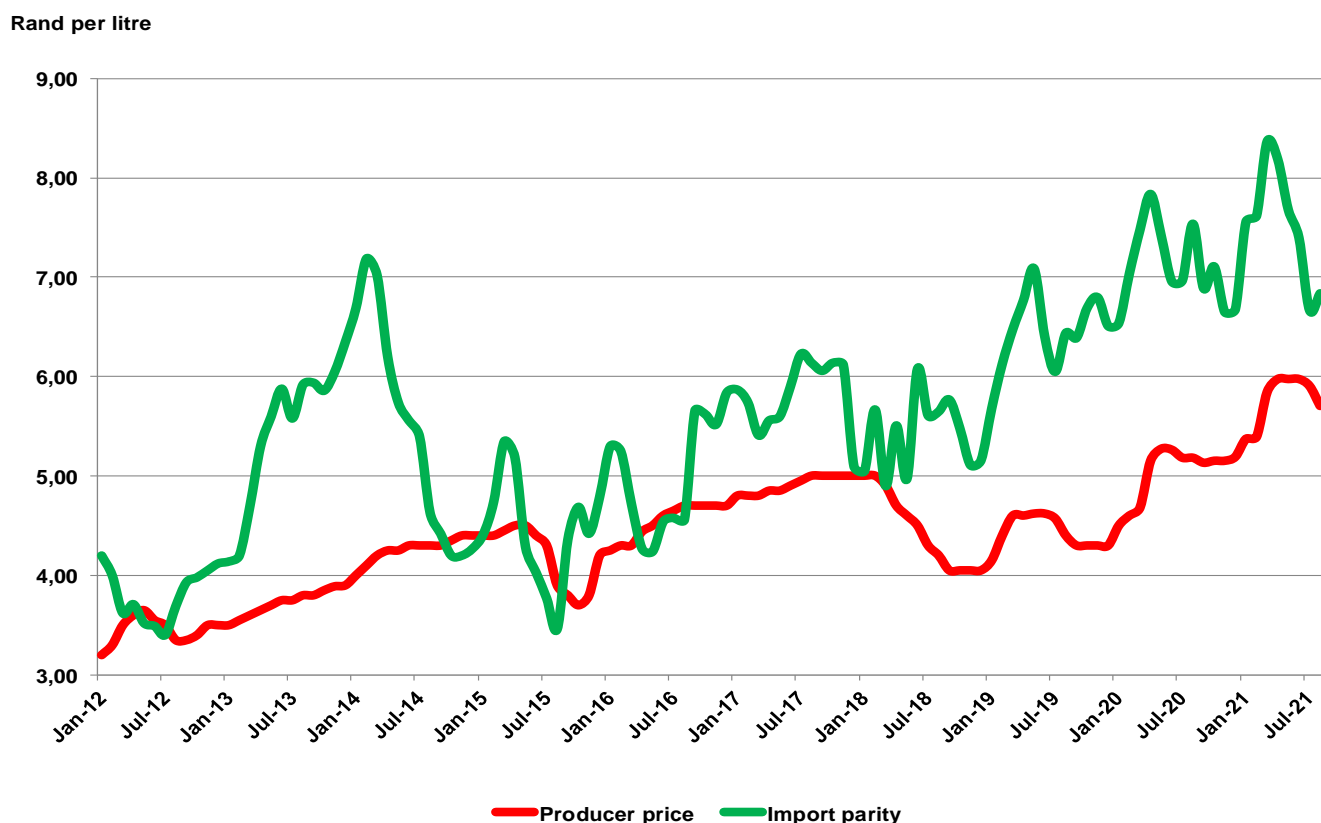


Figure 15 Monthly producer and import parity prices

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 2016 – 2021.

	2016	2017	2018	2019	2020	2021*
USA	1.6	1.7	1.1	0.3	2.2	2.4
EU	0.2	2.1	1.4	0.4	1.6	-0.1
AUS	-6.9	0	0.9	-7.3	2.8	0.6
NZ	-2.0	1.7	1.3	-0.8	0.4	5.6
URU	-10.4	7.6	5.7	-4.0	5.4	5.5
ARG	-14.4	-1.6	6.4	-2.3	7.4	4.1
ZA	-0.5	3.0	5.0	0.7	-0.16	-3.0

(Source: CLAL and Milk SA) *(2021 first six months)

Milk production at farm level has improved in 2020 compared to 2019 for all the major exporting countries. This is due to better climatic conditions and improved producer price levels. For the first six months of 2021 New Zealand experienced extra ordinary growth at 5.6%, while the EU and Australia are struggling. During 2020, South Africa was the odd one out, confirming that our producer price is trailing the rest of the world. This phenomenon was born in 2018 and is now in 2021 coming into fruition as unprocessed milk production is under pressure.

3. Economic overview

3.1 International economic outlook

After an estimated contraction of -3.3 percent in 2020, the global economy is projected to grow at 6 percent in 2021, moderating to 4.4 percent in 2022. The projections for 2021 and 2022 are 0.8 percentage point and 0.2 percentage point stronger than in the October 2020 WEO, reflecting additional fiscal support in a few large economies and the anticipated vaccine-powered recovery in the second half of the year. Global growth is expected to moderate to 3.3 percent over the medium term—reflecting projected damage to supply potential and forces that predate the pandemic, including aging-related slower labour force growth in advanced economies and some emerging market economies.

Thanks to unprecedented policy response, the COVID-19 recession is likely to leave smaller scars than the 2008 global financial crisis. However, emerging market economies and low-income developing countries have been hit harder and are expected to suffer more significant medium-term losses. Output losses have been particularly large for countries that rely on tourism and commodity exports and for those with limited policy space to respond. Many of these countries entered the crisis in a precarious fiscal situation and with less capacity to mount major health care policy responses or support livelihoods. The projected recovery follows a severe contraction that has had particularly adverse employment and earnings impacts on certain groups. Youth, women, workers with relatively lower educational attainment, and the informally employed have generally been hit hardest. Income inequality is likely to increase significantly because of the pandemic. Close to 95 million more people are estimated to have fallen below the threshold of extreme poverty in 2020 compared with pre-pandemic projections. Moreover, learning losses have been more severe in low-income and developing countries, which have found it harder to cope with school closures, and especially for girls and students

from low-income households. Unequal setbacks to schooling could further amplify income inequality.

Future developments will depend on the path of the health crisis, including whether the new COVID-19 strains prove susceptible to vaccines or they prolong the pandemic and the effectiveness of policy actions to limit persistent economic damage.

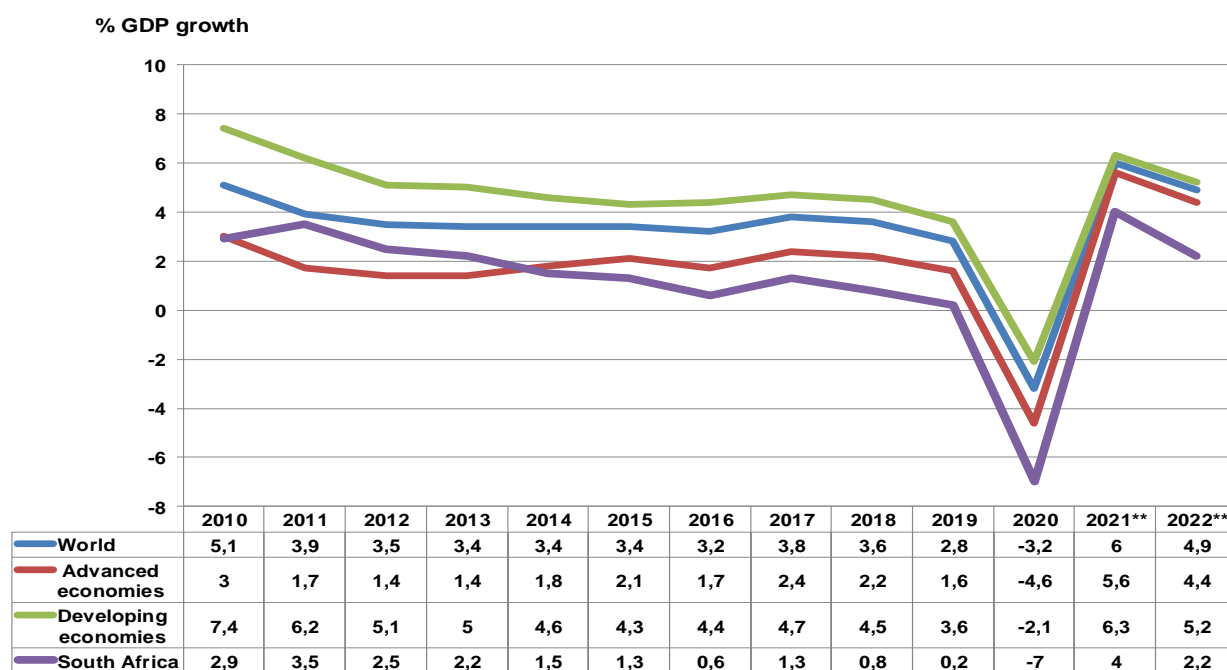


Figure 16 International economic growth and estimated growth

* Estimate

** Projection

Source: IMF WEO April 2021

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. Both composite indicators supports the hypothesis of a V-shape economic recovery for the South African economy. Both indicators trended north from May 2020. In July 2021 the leading indicator turned south indicating reduced future economic activity.

Indicators of economic activity

The co-incident indicator of economic activity show whether the economy is in an upwards or downwards phase of the business cycle. The leading indicator shows possible changes in economic activity in future.

Index (2000 = 100)

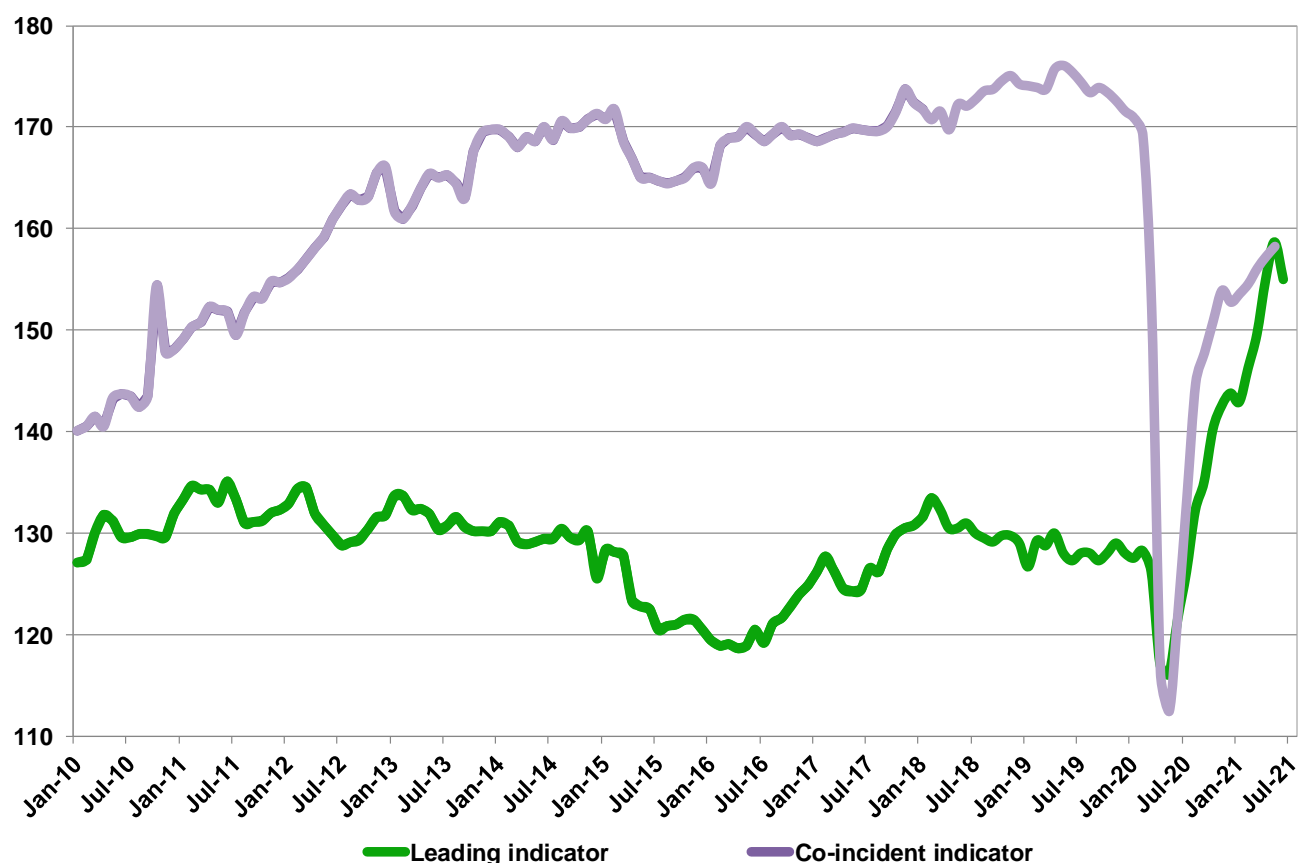


Figure 17 Leading and co-incident indicator of economic activity (Source: SARB)

Figure 18 shows the quarterly growth rate of the SA gross domestic product.

The South African economy in 2020 contracted with 1,8% in the first quarter, with 51% in the second quarter, expanded with 66% in the third quarter of 2020 and expanded with 6,3% in the last quarter of 2020 (annualised percentages). The SA economy registered a growth rate of -7,0% for the full year of 2020, which is the lowest over the past 60 years. In 2021, first quarter, the economy expanded with 4.6%.

Annual % change

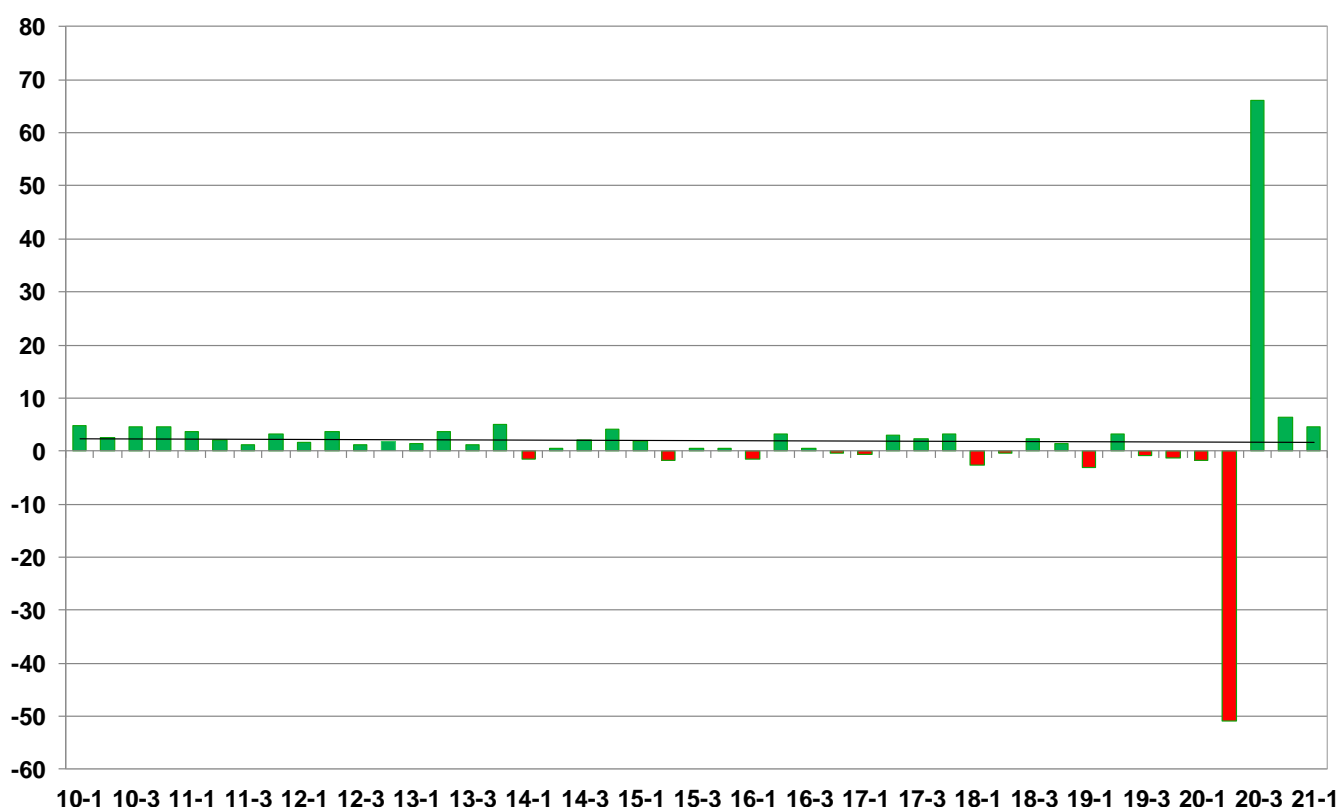


Figure 18 Quarterly change in real gross domestic product

Source: Stats SA

3.2.2 Household debt and income

Household debt increased in the third quarter of 2020 following an unprecedented decline in the second quarter. However, household debt as a percentage of nominal disposable income decreased from 86.5% in the second quarter of 2020 to 75.7% in the third quarter, as the increase in household disposable income exceeded that in debt.

3.2.3 Inflation

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

Annual consumer price inflation was 4,6% in July 2021, down from 4,9% in June 2021. The consumer price index increased by 1,1% month-on-month in July 2021. The main contributors to the 4,6% annual inflation rate were food and non-alcoholic beverages; housing and utilities; transport; and miscellaneous goods and services. Food and non-alcoholic beverages increased by 6,7% year-on-year, and contributed 1,1 percentage points to the total CPI annual rate of 4,6%. Housing and utilities increased by 3,8% year-on-year, and contributed 0,9 of a percentage point. Transport increased by 8,0% year-on-year, and contributed 1,1 percentage points.

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%.

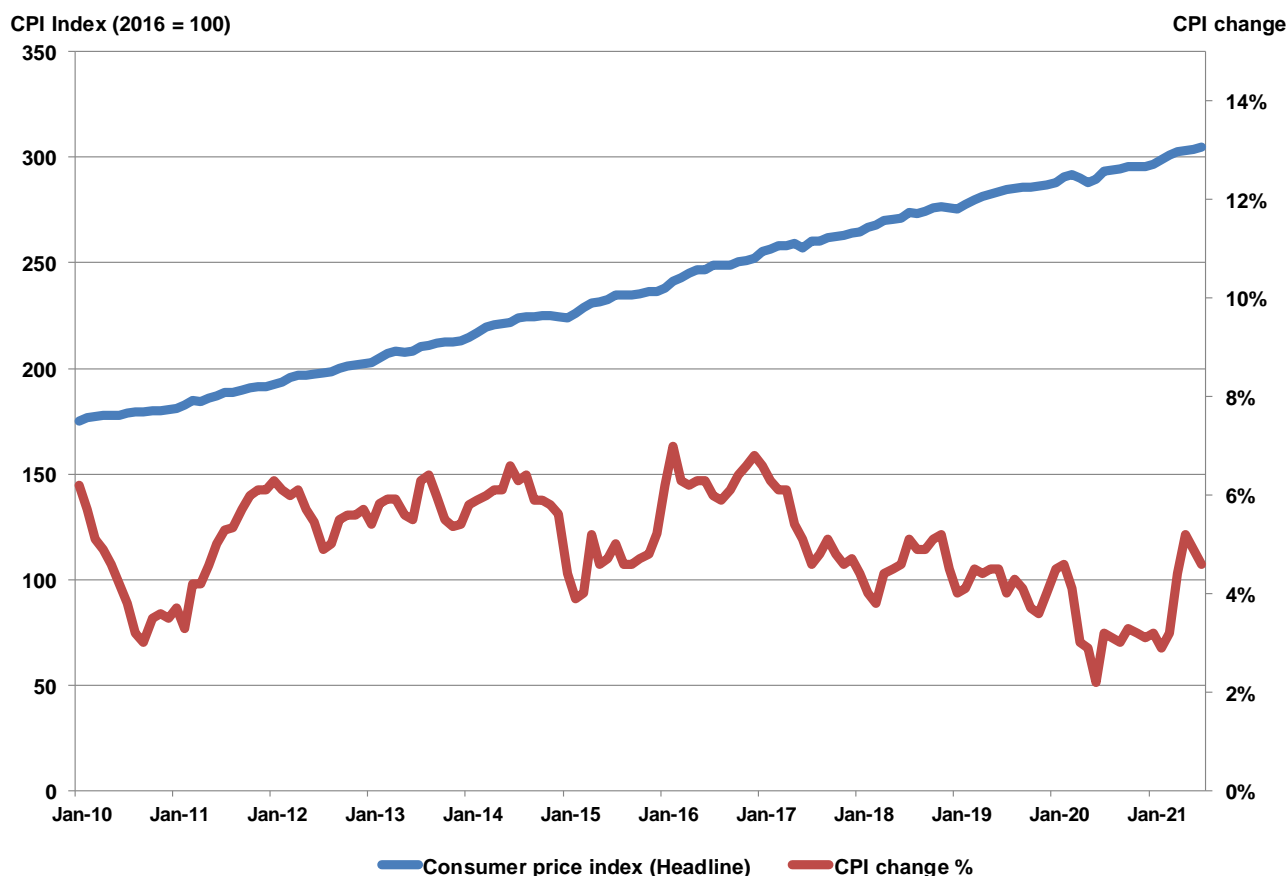


Figure 19 Consumer price index and consumer price inflation, 2007-2021

Source: Stats SA