# RECENT AND EXPECTED INFLATION TRENDS

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## 1. INTRODUCTION

Prior to considering the problem of inflation and expectations for 1976 it could be apposite to say a few words on the various ways of measuring inflation. For the layman and even for some people who should know better, more often than not this leads to confusion.

Broadly speaking inflation can be measured by means of the following series:

- the Gross Domestic Product (G.D.P.) deflator;
- the Wholesale Price Indices; and
- the Consumer Price Index.

### 1.1 The G.D.P. deflator

The G.D.P. deflator provides the most comprehensive measure of price changes, as it takes into account the price changes of all *South African* activities. Therefore it *includes* the price changes of all exports including gold but *excludes* the *direct* influence of the price changes from imported goods. Indirectly, however, imported inflation is also included in the index.

Owing to its complicated nature the G.D.P. deflator can only be derived annually and after a few quarters delay from national accounts statistics published by the South African Reserve Bank.

### 1.2 The Wholesale Price Indices

The Department of Statistics publishes *three* wholesale price indices each month. The wholesale price indices measure prices paid by the wholesale trade or they can also be regarded as measuring ex factory or ex farm prices. Price trends of services are not recorded by the wholesale price indices.

*1.2.1 Wholesale prices of commodities for South African consumption*

This index includes all wholesale prices of South African articles in agriculture, forestry, fishing, mining and quarrying, manufacturing, and electricity. It *excludes* prices obtained for *exports* but *includes* price movements of *imported* products. Of the three wholesale price indices this one is most common and usually the one referred to.

*1.2.2* Wholesale price index of output of South African *industry-groups in respect of total output*

This index measures price movements of the total output of all South African activity. It *includes* prices obtained for *exports* but *excludes imported* prices.

*1.2.3* Wholesale price index in respect of output of South *African industry-groups for South African consumption*

Price movements of all South African produced commodities for consumption in the domestic market only is included in this index. It therefore *excludes* prices obtained for *exports* or prices paid in respect of *imports.*

### 1.3 The Consumer Price Index

The consumer price index is also compiled on a monthly basis by the Department of Statistics. It is by far the best known index of price movements, represents the increase in the cost of living for the *average* White South African household and is normally used as the basis for reviewing salary and wage adjustments.

The consumer price index has three main components, namely:

- food, with a relative importance of some 25 per cent;
- services, contributing some 15 per cent to the total;
- commodities, representing 60 per cent.

The consumer price index can be regarded as giving the clearest indication of cost trends to South Africans since it *includes* price changes in respect of imports, *excludes* export prices and covers all sectors and spheres of the South African economy.

## 2. REASONS FOR THE DOUBLE DIGIT INFLATION EXPERIENCED OVER THE PAST TWO YEARS

In 1974 the consumer price index increased by 11,6 per cent. This year it should increase by about 13 to 14 per cent on average, despite the recent slowdown to an increase rate of 12,2 per cent.

What then were the reasons for the sharp increases? We should like to indicate the following:

- increases in salaries and wages in excess of labour productivity improvements;
- the sharp increase in the oil price;
- high inflation rates in the economies of our trading partners;
- excessive international demand for raw materials;
- sharp increases in domestic prices of basic foodstuffs.

### 2.1 Increases in salaries and wages in excess of labour productivity improvements

According to our calculations, the average annual wage for all races increased by some 57 per cent over the period from 1970 to 1974. In sharp contrast with this stands the increase in average labour productivity over the same period. This increased by a moderate 7,2 per cent.

Even more striking are the increases in the salaries and wages of the various racial groups. Statistics indicate that over the four-year period from 1970 to 1974 average White incomes increased by some 50 per cent, Coloured incomes by 65 per cent, Asian incomes by 70 per cent, and Black incomes by almost 82 per cent.

In the year 1974 average wages for all races increased by 18 per cent, with preliminary indications of a slightly lower rate of increase for 1975. Especially in recent months it would seem that the rate of increase has been showing signs– sharp increases in domestic prices of basic foodstuffs.

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In the year 1974 average wages for all races increased by 18 per cent, with preliminary indications of a slightly lower rate of increase for 1975. Especially in recent months it would seem that the rate of increase has been showing signs weighted according to importance for South Africa, shows that in 1974 the average increase was in excess of 20 per cent but that the rate of increase was declining towards the end of the year. This trend was continued during the first nine months of 1975, with the latest figure some 8 per cent above that of a year ago.

### 2.4 Excessive international demand for raw materials

Owing to a sharp increase in the demand for especially metals and minerals as well as certain agricultural products, prices increased sharply during 1973 and the first half of 1974. Since then a decline has set in, and recently prices of these products have been drifting sideways at the lower levels.

### 2.5 Food price increases

Throughout 1974 domestic food prices continued to accelerate at a rate well in excess of the average price increase. Thus in January 1974 the index was 13,4 per cent higher than in January 1973. By December 1974 the annual rate of increase had accelerated to 18,2 per cent, increasing further to reach a peak of 21,5 per cent in February 1975. Since that time a declining trend has set in, and the latest figure, namely that for October, reflects an annual increase of 11,2 per cent.

## 3. INFLATION EXPECTATIONS FOR 1976

Widespread differences of opinion exist about the possible rate of inflation in 1976. The recent devaluation of the rand, which is inflationary in effect, resulted in even greater uncertainty and speculation. The most optimistic forecast we have seen is an expected 10 per cent rate of inflation. The other extreme is represented by some 30 per cent, with the majority of economists suggesting something around 20 per cent.

Having made our assumptions and calculations, we at Senbank believe that in 1976 the consumer price index may increase at an average rate of 13 to 14 per cent. We will discuss the underlying reasoning shortly.

The main negative force that can lead to higher inflation rates undoubtedly is the devaluation of the rand of 18 per cent. Again this must be seen in conjunction with its influence on the consumer price index as well as with the prevailing stage of the business cycle.

In the wholesale price index of commodities for South African consumption,— imported goods have a relative weight of about 25 per cent, and therefore it can be expected that the total wholesale price index will increase by some 6 to 8 per cent, taking into consideration the secondary effects as a result of the devaluation of the rand.

The effects of the devaluation on the consumer price index will, however, be much less severe, as manufactured products with an imported component have a much smaller influence on the consumer price index. We do not think that the escalation effect of devaluation on the consumer price index will be more than 3 per cent under normal circumstances.

However, the stage of the business cycle is also of importance when attempting to determine the effect of devaluation on the consumer price index. At this moment in time, and we believe this will also be the case during the next six to nine months, South Africa's imports are declining because of high domestic stock levels, a relative low growth rate, and ample surplus capacity that reduces the need for the large imports of especially machinery. In the final instance volume of imports and prices taken together determine the total cost escalation effect of devaluation. To quantify this factor is indeed difficult. It is, however, sufficient to take note of it as a force contributing to the reduction of the adverse effect of devaluation on the cost structure. We also believe that, as happened in 1972, the rand will appreciate to some extent in 1976, thus reducing the cost-escalating effect of the recent devaluation.

Positive elements, however, are the following:

### 3.1 Food prices

In recent months food prices have been increasing at rates well below the average for the past eighteen months, and indications exist which lead us to believe that the sharp increases of the immediate past will not be repeated in 1976.

### 3.2 Productivity

The sharp increase in salaries and wages of recent years has forced businessmen to economise in their use of labour. Men are therefore being replaced by machines, with the result that the total wage bill is increasing at a slower rate. Higher labour productivity performances are also expected especially in 1976, should present unused capacity be occupied more fully. According to Senbank's calculations the annual rate of increase in unit cost of production in industry has already declined from 20 per cent in the first quarter of 1975 to 14 per cent in the third.

### 3.3 The oil price

After increasing by a few hundred per cent at the end of 1973 the oil price has recently been increased by "only" 10 per cent. The direct as well as indirect influence of this increase should be much less distorting and cost escalating in 1976. Moreover, no hefty increases are foreseen for 1976.

### 3.4 International inflation

Whereas inflation rates soared in 1974, thus far a sharply declining trend has been noted in 1975. It would seem that the Western world has become much more stability orientated and less orientated towards "growth at all cost". Although internationally we expect renewed growth in 1976 we do not expect inflation rates to start accelerating or nearly to reach the increased rates experienced in 1974. In any case the sharp increase in the oil price and the price increases of other metals and minerals seen in 1973 and the first half of 1974 will most certainly not come about again in 1976.

### 3.5 Taxation

In the March 1975 national budget, excise duties were increased, which effectively added 1 per cent to the inflation rate. We do not foresee a further increase in either sales duties or excise and custom duties in the March 1976 budget.

## 4. SUMMARY

High inflation rates are not a new phenomenon in the world economy. In fact the early fifties experienced more or less similar inflation rates than those of recent times, followed by a period of relative stability.

Although we do not foresee a return to inflation rates of 2 to 3 per cent in the years immediately ahead, we also do not believe that constant double digit inflation rates should be regarded as a permanent feature of our economy. In fact we believe that the economy cannot bear such inflation rates for an indefinite period of time, and consequently self-correcting measures will set to work to eliminate abnormal inflation rates. Sometimes this would, however, seem to take a bit longer.