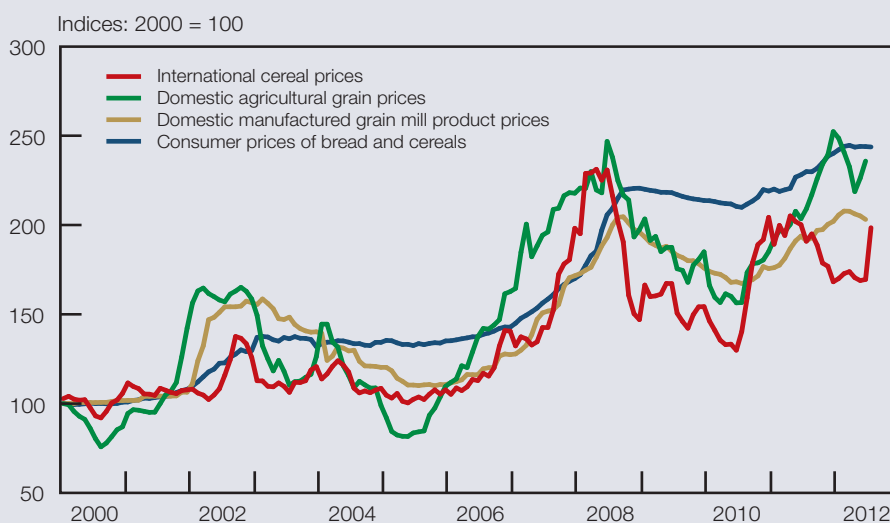


### Box: Grain price developments and inflation prospects

Developments in grain prices have a large bearing on inflation outcomes and the inflation trajectory mainly through the bread and cereals category, which constitutes almost 22 per cent of the consumer food price basket. In addition, grain price developments affect consumer price inflation through changes in the production cost of meat products, as they influence livestock feed costs.

Whereas in the opening months of 2012 market participants expected international grain prices to decrease in the current season on account of historically large areas planted in especially the US, the opposite outcome transpired more recently. Following a severe deterioration of maize crop prospects in the US as a result of drought coupled with extreme heat conditions during the critical stages of crop development, maize prices increased, on average, by 23 per cent in July 2012 compared with the preceding month. Simultaneously, international wheat prices surged by 19 per cent amid a worsening of production prospects in the Russian Federation and expectations of a firm demand for wheat from the livestock sector for the second consecutive season due to tight maize supplies.

#### Grain prices



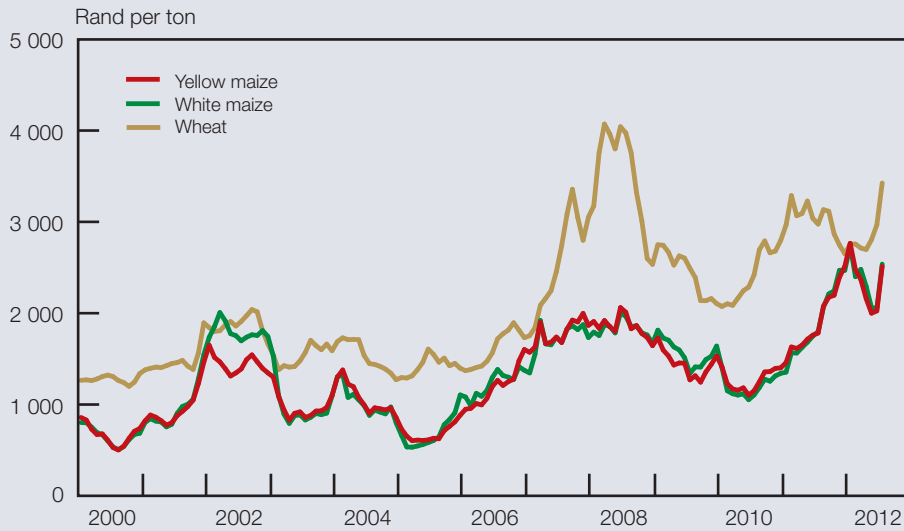
Sources: Food and Agriculture Organization of the United Nations and Statistics South Africa

South Africa, being a small and open economy, is subject to international food price developments through import and export parity pricing practices. Given the surge in the international price of grain more recently, coupled with reduced domestic crop estimates, domestic maize and wheat prices consequently increased steeply. In fact, the prices of white and yellow maize respectively increased by 23,2 per cent and 25,6 per cent from May to July 2012, while that of wheat increased by 22,1 per cent.

According to most recent crop estimates made in August 2012, the size of the expected commercial maize crop for the 2012 harvesting season is 11,2 million tons, which is 4,3 per cent lower than the original estimate. However, this most recent maize crop estimate still exceeds the final crop for 2011 by 8 per cent. Concerning wheat production, the preliminary estimate of hectares planted decreased by 8,8 per cent compared with the previous season. This is the smallest area planted since the early 1930s. This decrease in the area planted resulted primarily from less favourable soil moisture conditions at the outset of the 2012 wheat planting season. Local wheat plantings are, however, not projected to continue the declining trend of the previous decade.

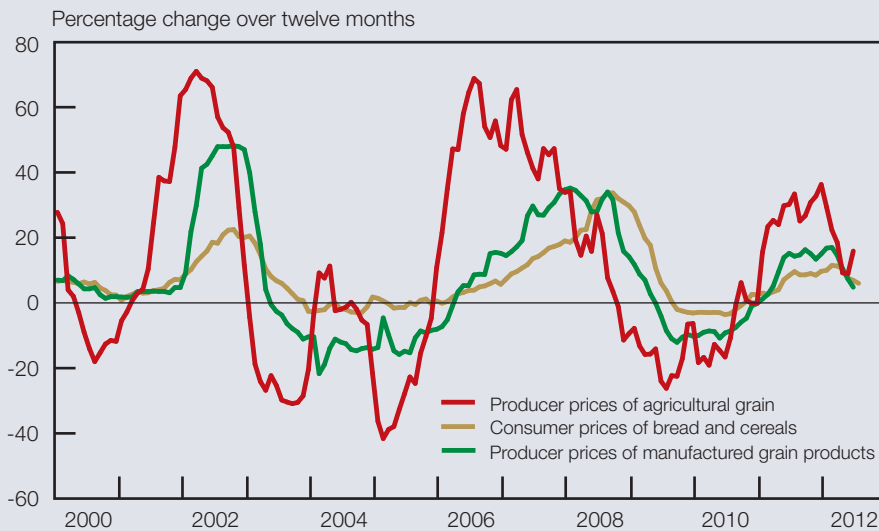
As indicated in the figure at the bottom of page 21, changes in the agricultural producer prices of grain precede those in the producer prices of manufactured grain products. As products move through inventory holdings and various stages of production, these changes are then transmitted through the price formation process, eventually impacting the consumer prices of bread and cereal products. While the lags between these various stages in the price formation process are not constant over price cycles, a fair amount of consistency in terms of the sequencing of price changes is nevertheless clearly evident in the accompanying graph. Following a deceleration in the rates of increase in the producer prices of grain since the closing months of 2011 and the production

### Domestic spot prices of maize and wheat



prices of manufactured grain in the opening months of 2012, price increases of bread and cereals moderated thereafter. Given this relationship in terms of price trends, it can be expected that the most recent rise in the producer prices of grain will place upward pressure on bread and cereal prices towards the end of 2012. It is generally expected that maize meal price increases will peak at around 10 per cent, while inflation in the price of brown bread will be in excess of 20 per cent, year-on-year, within the next six months.

### Domestic grain price inflation



Climate allowing, the current attractive producer prices of maize bode well for the area to be planted in the approaching planting season, and should support the adequacy of supplies in 2013. For monetary policy an important question is how much of the present and near-term movements in food price inflation will still be left at the operational time horizon of monetary policy, that is, 18 to 24 months into the future.