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The Household Sector Economy

Middle East Conflict – Transport Inflation impact likely bigger on private transport and higher income groups. But broader impact possibly greater on lower income groups

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The 2022 oil and domestic transport fuel price spike showed us that South Africa's private transport users are likely to experience the most severe direct transport cost inflation impact during an oil price shock, while public transport inflation should be less severe.

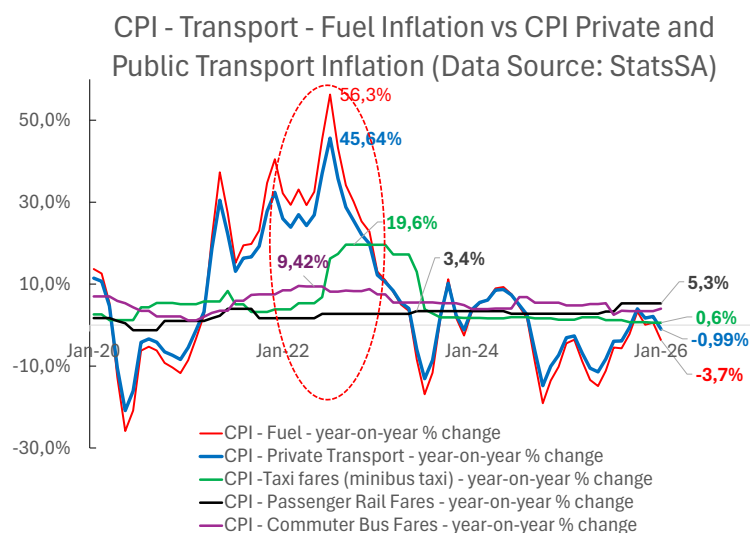
As the days go by, and oil prices continue to remain “elevated” from a few weeks ago, due to the Middle East conflict in and around Iran, the concern surrounding a looming shock to South African petrol prices is understandable.

Much of the discussion seemingly centers around how high next month's petrol prices may go, what happens beyond that, how far inflation rises as a result and will that lead to interest rate hikes?

Less discussed, however, is how public transport where it is available in South Africa potentially cushions the blow of such oil and domestic petrol price shocks. If anything, these periodic bouts of high petrol prices should serve to remind us of the need to develop far more comprehensive and better quality public transport for South African cities.

When breaking down the modes of land transport in order to view the impact of oil price shocks, it appears that those having to use private transport will likely be more directly impacted, whereas public transport inflation during a fuel price shock might be less severe. In times of a fuel price shock, public transport operators appear to absorb a portion of the cost increase, while in the fuel price dips they don't cut fares accordingly, thus smoothing out the volatile fuel price cycles for public transport users quite significantly.

Viewing the CPI (Consumer Price Index) inflation rates of major land transport modes, and how they responded to the last oil and petrol price surge in 2022, is informative, and the divergence in inflation rates was significant.



The 2022 oil price shock was also driven in large part by a conflict, that time around the onset of the Russia-Ukraine war in February of that year. Sanctions imposed on Russian oil and gas caused supply disruptions, and the result was a global energy price surge.

After ending 2021 on \$77.24/barrel, Brent Crude oil price peaked above \$128/barrel in June 2022. The result was a major surge in domestic fuel prices, and the CPI inflation rate for Transport Fuel accelerated to a high of 56.3% year-on-year in July 2022, before tapering rapidly thereafter.

For private transport users there was no place to hide, and private vehicle user running costs rose the most rapidly.

The CPI for Private Transport saw its inflation rate peak at a very high 45.64% year-on-year in that same month.

By comparison, the minibus taxi fare inflation rate peaked at a significantly lower 19.6% around the same time, while bus fares surged to a far lower inflation peak of 9.42%.

The highest inflation rate shown by train fares around that time was only 3.4%.

Admittedly, buses and trains are more heavily subsidized, but the slower rate of inflation in largely unsubsidized taxi fares, compared with private transport inflation, is insightful.

These divergent inflation rates reflect on public transport being potentially important in “smoothing out” the peaks and troughs, in what are sometimes extreme fuel price fluctuations, and their impact on the household sector.

On top of this, public transport should on average have a significantly lower fuel cost per passenger kilometer than private vehicle transport, which is also beneficial in reducing the impact of high fuel costs on households on a sustained basis.

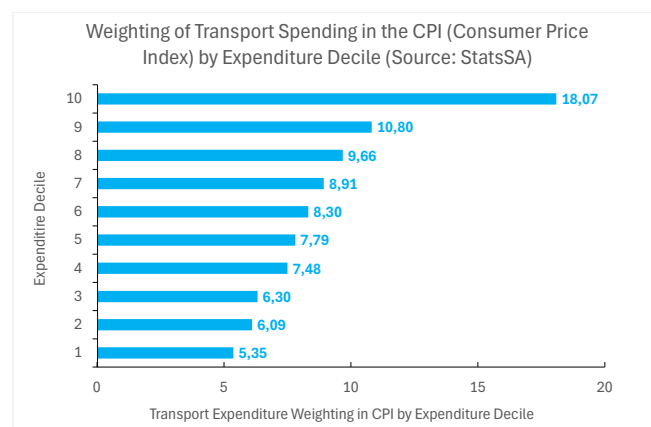
South Africa's very limited public transport system, and heavy use of private transport, especially by middle to higher income segments of the population, arguably exacerbates the problem of periodic oil and fuel price shocks.

Direct fuel price shock impact is more significant for higher income households.

With most existing public transport in South Africa catering more for the lower income and expenditure segments of the population, higher income/expenditure groups rely heavily on private transport, on top of being more “transport-intensive” in their spending overall.

CPI split by “expenditure decile” shows the top 10% of spenders (Spending of more than R307,886/year, these expenditure deciles strongly tied to income

levels) having the highest Transport weighting of 18.07 in their overall CPI expenditure “basket” of items. As we move down the deciles to the lower expenditure group end, the weighting declines, with the lowest expenditure decile (Less than R35,864/year, the poorest group in other words) only having a transport weighting of 5.35.



The lower weighting of transport in lower expenditure/income groups’ baskets of spending items, coupled with their greater dependence on the less petrol price-sensitive public transport modes, means that a direct fuel price shock impact is more significant on higher income groups than on lower income groups.

But it is never that simple, and the broader potential Middle East Conflict-related price impacts complicate matters:

- **Lower income groups have less financial buffers for general price shocks**

The direct fuel price impact is not the whole story though. It is important to acknowledge that lower income/expenditure groups are more vulnerable even to small inflation surges than higher income/expenditure groups, because generally they have less financial buffers with which to weather a price inflation storm.

- **A broader Middle East Conflict-related inflation surge, especially in food prices, could place lower income households more at risk**

In addition, it must also be remembered that fuel price inflation surges feed through to broader inflation.

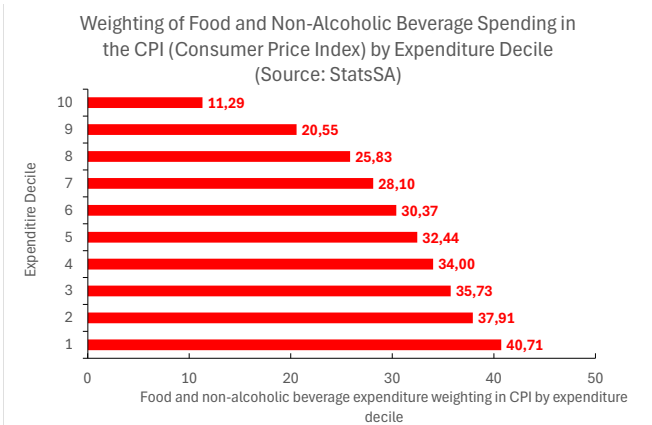
Furthermore, a key reported concern surrounding the Iran Conflict is a potential food price impact via fertilizer supply disruptions, over and above regular fuel cost increases.

A significant portion of the world’s fertilizer supply is manufactured in the natural gas-rich Middle East, and is reportedly subject to conflict-related supply disruption risks. It is a key agriculture input, along with diesel, and could thus potentially impact food prices along with higher diesel prices.

If food prices were indeed to be materially impacted,

that would be an impact felt more by the lower expenditure groups, who have a far higher weighting of food and non-alcoholic beverage spending in their overall CPI “basket” of items.

Whereas the highest expenditure decile, decile 10, has a relatively low food and non-alcoholic beverage spend weighting of 11.29 in its overall CPI “basket” of items, the poorest decile, decile 1, has an extremely high weighting of 40.71 for this expenditure category. Should there be any significant impact on food prices emanating from an oil price and fertilizer shock, this could be potentially more severe on the lower expenditure groups who also generally have the weakest financial buffers with which to ride an inflation storm.



IN CONCLUSION

The 2022 oil price “spike” history points to public transport users in South Africa having experienced less of a direct transport cost shock than private transport users. This is insightful as to what may likely happen should domestic fuel prices rise sharply in the near-term.

It is likely that public transport users will experience a lower transport cost inflation surge than will private transport users. This suggests that higher expenditure households will experience a bigger direct transport cost inflation impact in a fuel price shock scenario. Firstly, this is because they use private transport more than lower income groups, and secondly because the weighting of their transport spending in their overall expenditure basket is higher than that of lower expenditure groups.

However, the overall inflationary impact of an oil price shock, along with other Middle East Conflict-related supply disruptions, on general consumer price inflation levels, could still impact more severely on lower expenditure groups. This is firstly due to their lack of financial buffers with which to absorb inflation surges in general. Secondly, the food and non-alcoholic beverage weighting in their overall expenditure basket is far higher than that of higher expenditure groups. So, if food prices were to be significantly impacted by the Middle East Conflict, in the form of key input cost increases from a domestic fuel as well as a fertilizer supply shock, that could be a particular problem more for lower expenditure/income households.

At present, though, the extent of inflationary impacts emanating from the Middle East Conflict remain as tough to predict as the future path of the conflict itself.

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