ANZ Research

September 2023 Quarter CPI Review

17 October 2023

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Data summary

	% qtr	% ann
Headline CPI	1.8%	5.6%
Tradable	1.8%	4.7%
Non-tradable	1.7%	6.3%

Progress buys time

- **We now expect the RBNZ to hike the OCR 25bp in February, rather than November.**
- Annual CPI inflation decelerated from 6.0% in Q2 to 5.6% y/y in Q3, weaker than our forecast of 6.1%, and below the RBNZ's August MPS forecast of 6.0%. The downside surprise was on the tradables side.
- Non-tradables inflation came in at 6.3% y/y, slightly above the August MPS forecast of 6.2% y/y but below our forecast of 6.5%.
- While still far too high, core inflation measures improved, which will be pleasing for the RBNZ. CPI excluding food, fuel, and energy fell to 5.2% y/y (6.1% previously). Trimmed mean measures largely eased. At the 30% trim level, inflation eased from 6.0% y/y to 5.6% y/y. Weighted median inflation eased from 6.6% y/y to 5.0% y/y.
- Tradables inflation (largely imported) came in at 4.7% y/y (5.2% previously), well below our forecast of 5.5% y/y and the RBNZ's forecast of 5.8% y/y. Petrol prices were higher, but not as high as we expected. Petrol price moves will be looked through, at least as long as inflation expectations continue to ease.
- The details of today's data support our view that domestic-driven inflation pressures remain a significant problem. However, clear progress was evident, and that takes pressure off the RBNZ to move the OCR any time soon. In short, 'hope for the best' remains a valid strategy. Accordingly, we have pushed our forecast hike out to the next meeting, the February Monetary Policy Statement.
- All eyes now turn to the Q3 labour market data on 1 November, with the RBNZ having flagged the importance of wage growth at the October Monetary Policy Review.

Big picture

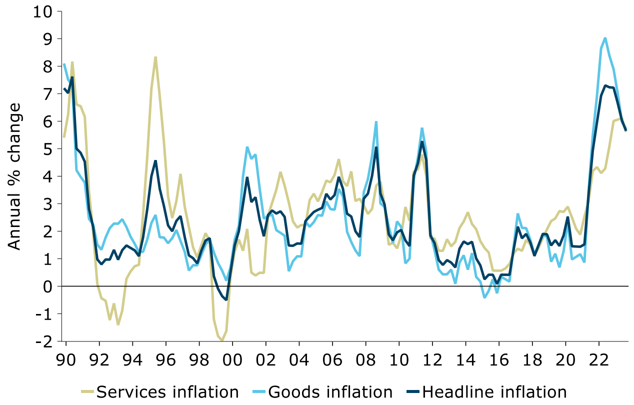
Much weaker than expected tradables (largely imported) inflation saw annual inflation fall in Q3, though sticky domestic inflation pressures will remain a key concern for the RBNZ. Even stripping out all the noise from sharply higher fuel prices, the unwind of transport subsidies, and bumper increases in local council rates, the data continues to show that domestic-driven inflation pressures are still very strong.

The proportion of the CPI basket running in excess of the 2% target, was unchanged at 84% while the proportion in excess of 5% eased only to 54%. Extreme inflation continues to fade, but there remains a risk that inflation is normalising above the RBNZ's target midpoint of 2%.

Services inflation eased from 6.1% to 5.6%, in part reflecting the significant loosening in labour market pressures this year as a result of both easing labour demand and particularly, imported labour supply. That said, the quarterly impulse of 2.2% q/q certainly signals a need for further progress. While the suite of core measures remained far too high for comfort for the RBNZ, falls across the suite will certainly provide some relief. Trimmed mean measures broadly eased, with the 30% trim measure falling from 6.0% y/y to 5.6%. Inflation excluding food, fuel and energy fell sharply from 6.1% y/y to 5.2%. The weighted median inflation rate also plummeted from 6.6% y/y to 5.0% y/y. These are all things the RBNZ needs to see, but it's still a long road ahead, and the quarterly impulses across the suite of core measures still suggest that the RBNZ's domestic inflation outlook, which is for domestic inflation pressures to plummet from Q4 onwards, is very optimistic.

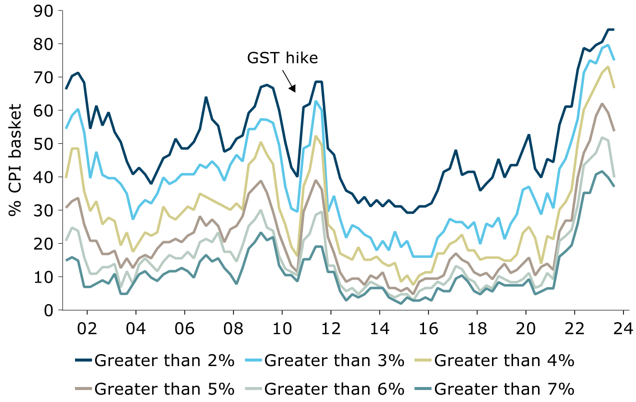
There's no question that inflation pressures are easing. But nor is it in question that inflation, however you cut it, remains too high and that progress has been slow. The RBNZ will be relieved by today's data even though all of the downward surprise stemmed from the tradables (largely imported) component. But we are not out of the woods yet with non-tradables inflation showing worrying persistence. The RBNZ revised their near-term non-tradable inflation forecast higher at the August MPS, and they are likely to need to do so again at the November MPS. That now looks unlikely to get them over the line for a hike, but we think it will in time (see page 3 for more discussion).

Figure 1. Goods and services inflation



Source: Stats NZ, Macrobond, ANZ Research

Figure 2. Proportion of the CPI basket running greater than X% y/y



Source: Stats NZ, Macrobond, ANZ Research

The details

Turning to the details, of the 1.8% q/q increase in consumer prices in the September quarter:

- Food prices (18.8% of the CPI basket) lifted 0.9% q/q. Signs of a broad-based moderation were evident in Q3, as cyclone-related supply disruption faded and lower global food prices finally found their way onto New Zealand shelves. We expect seasonal falls in fresh fruit and vegetable prices into summer will see food prices drag down headline inflation, though El Niño looms as a upside risk.
- Housing-related costs (27.8% of the CPI basket) remain a key driver, rising 1.7% q/q – stronger than the 1.4% q/q we pencilled in. Rent prices were up 1.2% q/q, to be up 4.4% y/y. Housing construction costs also rose 0.6% q/q, weaker than our expectation of 0.9% q/q. Construction cost inflation is now below its historical average, and while demand is weakening, housing market momentum may see that change. Local council rates rose a whopping 9.4% q/q, symptomatic of broad-based inflation pressures across the economy.
- The transport group (13.5% of the CPI basket) rose 7.1% q/q, stronger than the 6.3% increase we expected. Petrol prices, as expected, were the key driver, 16.5% q/q, though that was less than the 20% q/q increase that weekly fuel price data had suggested. Domestic airfares rose sharply up 10.4% – that's one component of non-tradables inflation that the RBNZ will look through, though the continued strength of price increases highlight that demand is holding up, and consumers are still willing to accept high prices.
- The household contents and services group fell 1.4% q/q, much weaker than the 1.1% q/q lift we expected, highlighting ongoing global goods disinflation. This was a common theme across the release, with tradables inflation excluding fuel only lifting 0.2% q/q.

Monetary policy implications

It's a high bar for the RBNZ to restart hiking. Today's data hardly screams 'job done' but it does give the Committee a little more breathing room to wait and see whether domestic inflation pressures dissipate quickly from here.

We continue to believe that on balance a 5.5% OCR is likely to prove insufficient to bring inflation back to target in an acceptable timeframe, for two main reasons:

- The economy is not rolling over as fast as the RBNZ expects (migration and fiscal policy being the likely culprits), and
- The RBNZ's forecast that non-tradable inflation is about to start to plummet from next quarter looks more founded on optimism than anything else.

But when sufficient evidence will have accrued to get the RBNZ off their on-hold perch is unclear. Let's break it down into reasons to hike in November, and reasons not to do so (assuming the labour market data on 1 November isn't a game-changer, with our forecasts and the RBNZ's not meaningfully different).

Reasons to hike in November:

- The OCR track in August already suggested a third chance (9bp) that another OCR hike would be delivered. Just another +4bp on the track would see the discussion tip towards justifying why the Committee is not hiking, rather than why it is.
- The RBNZ's August forecast that non-tradable inflation is about to plummet still seems unlikely to materialise. While today's data was in line with the RBNZ's forecast, given positive growth news the RBNZ is nonetheless likely to be revising up its forecast of non-tradable inflation in November. The near-term risk that the economy doesn't cool as fast as the RBNZ expects remains highly pertinent.
- If the RBNZ doesn't hike, it may struggle to find the right words to keep monetary conditions suitably tight over the summer.

Reasons not to hike in November:

- The three-month gap to February means that the RBNZ will have updated reads on the full suite of monthly and quarterly economic data, as well as more information about the outlook for fiscal policy. Of course in practice, updated data always raises as many questions as it answers, but we economists always live in hope!
- The downside surprise on imported inflation pressures isn't something the RBNZ can take credit for, but it still matters. This may offset any upward revisions to non-tradable inflation forecasts to some extent.
- Monetary policy is cooling the economy, and is likely to keep working over the summer. As long as things are going in the right direction, the temptation must naturally be to wait and see how things pan out, and hope for the best. The potential cost to that strategy is that rates may eventually need to go higher than otherwise, but that's a problem for another day.
- If the market gets ahead of itself in wanting to price cuts over the summer, the RBNZ has the option of a hawkish speech to reset market expectations.
- In the meantime, downside risks haven't gone away (China and commodity prices, global financial stability vulnerabilities). There's a chance the whole picture could change abruptly.

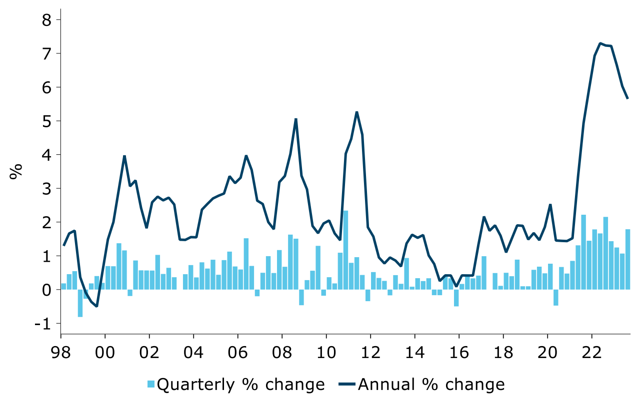
The latter list is now more convincing. Assuming that unemployment and labour market data doesn't spring any surprises, our take is that the fall in the non-tradable and core measures in the CPI buys the RBNZ more time to see how things pan out over coming months, meaning a hike as soon as November now looks unlikely. However, we still think on balance the risk is that the OCR is not high enough to do the job of bringing inflation down to target in an acceptable time frame. Accordingly, we are pushing out our 25bp hike to February, taking the OCR to a peak of 5.75% as before.

Of course, there is a risk in changing our November OCR call now, and not waiting for the release of the Q3 labour market data on 1 November. The RBNZ talked about the importance of wage developments in the October Monetary Policy Review, and rightly so. But ANZ and the RBNZ have very similar expectations for the labour market suite: a small tick-up in the unemployment rate (but still under 4%), and wage growth remaining high (QES 7.1% y/y and private sector LCI a bit over 4% y/y).

Market reaction

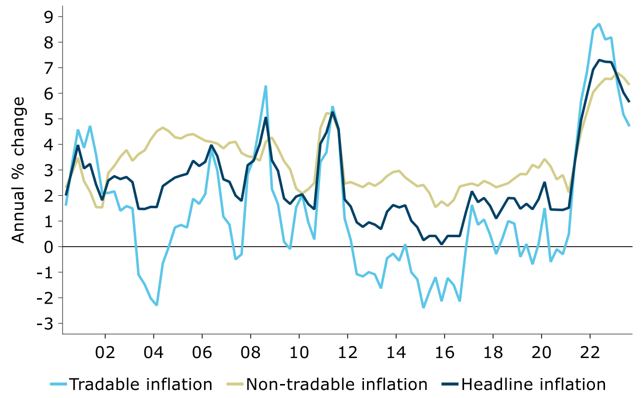
Short-term interest rates and the NZD fell after the release of the data, which was to be expected given that the headline came in below our forecast and those of all other domestic economists. It's clear from the underlying details of the CPI report that the RBNZ isn't out of the woods yet, but as long as things are going their way, markets will struggle to get behind a November hike. But we expect markets to continue to price in some risk of hikes over the next few meetings given signs of stickiness in core and non-tradable inflation. The focus now shifts to Q3 labour market data (wages in particular) in a couple of weeks' time.

Figure 3. Headline CPI inflation



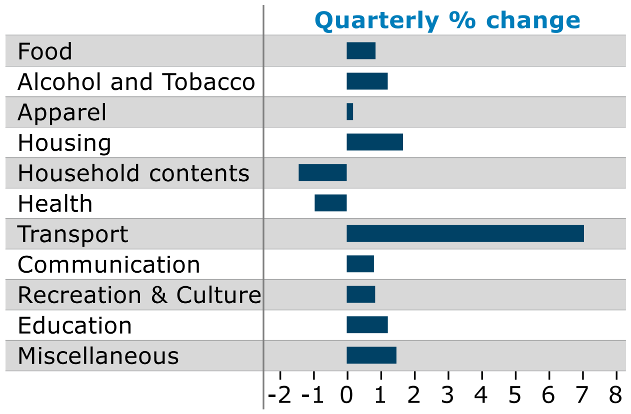
Source: Stats NZ, Macrobond, ANZ Research

Figure 4. CPI inflation components



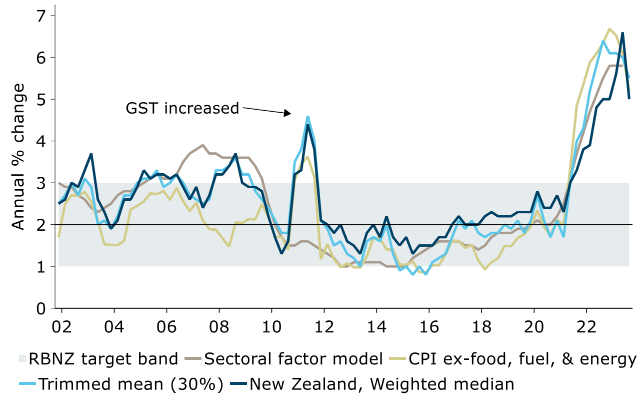
Source: Stats NZ, Macrobond, ANZ Research

Figure 5. CPI groups – September 2023 quarter



Source: Stats NZ, Macrobond, ANZ Research

Figure 6. Core inflation measures



Source: Stats NZ, RBNZ, Macrobond, ANZ Research

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