

Consumers Price Index – 2020Q2

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Contact

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Weak as a kitten

- CPI contracted 0.5% q/q in Q2 – a touch stronger than the -0.6% we (and the market) had pencilled in, but only due to rounding.
- Annual headline inflation decelerated 1.0%pts to 1.5%. We think it'll be below the 1-3% target band by year end.
- These data captured a fair amount of lockdown-induced noise, dragging on quarterly inflation. That suggests Q3 will include a healthy dose of payback (but with underlying inflation continuing to decelerate).
- Looking through the noise, inflation and employment headwinds reinforce the need for further action from the RBNZ.

Key points

Headline CPI contracted 0.5% q/q in Q2, with annual inflation decelerating 1.0%pts to 1.5%. But we always knew Q1's 2.5% y/y read was going to be the high tide mark for inflation for quite some time. Non-tradable (domestic) inflation was flat (0.0% q/q, as we had pencilled in), with the annual read slowing 0.3%pts to 3.1%. Tradable inflation contracted a little more than expected, down 1.2% q/q (ANZ: -1.1%), to be down 0.6% y/y.

Core inflation measures were relatively stable, but softened. There's still plenty of water to flow under the bridge here.

- the weighted median fell 0.4%pts to 2.4% y/y;
- inflation excluding food and energy fell up 0.4%pts to 1.9% y/y;
- annual trimmed mean measures fell across the board (by 0.6-1.2%pts), with the 15% level of trim now running at 1.8% y/y.

The RBNZ's sectoral factor model will be released at 3pm. This can be slow moving, so may not deteriorate significantly. Nonetheless, the medium-term outlook for inflation (and employment) will be making the RBNZ very concerned. We expect headline CPI will be running below the 1-3% target band by year end. The [NZD is elevated](#), world prices are seeing deflationary pressure, inflation expectations are at record lows, and labour market capacity is set to increase markedly. The RBNZ has a momentous battle on its hands. Without further action or a significant change in the economic outlook, the risk of a persistent undershoot is likely to materialise.

Turning to the details of the Q2 release:

- Food prices lifted 1.1% q/q (contributing +0.2%pts). That's a little stronger than is typical in a June quarter, but it's hard to know how much was minimum wage-induced and how much is lockdown noise.
- A 12.1% fall in petrol prices in the quarter was a pretty significant drag on headline inflation (-0.5%pts). Free rail passenger transport in some regions saw prices decline 48.2% q/q. These prices will bounce back sharply in Q3. Together with petrol, this saw the transport group contract a whopping 4.9% q/q (-0.7%pts). Our own monitoring had the transport group down 7.1% q/q. Suppressed prices (on confidentiality grounds) for road passenger and domestic air travel mean we can't reconcile the difference.

Data summary

	% qtr	% ann
Headline CPI	-0.5%	1.5%
Tradable	-1.2%	-0.6%
Non-tradable	0.0%	3.1%

The recreation and culture group fell 1.3% q/q (-0.1%pts) led by unseasonably weak accommodation services (5.7% q/q). There was a fair amount of discounting taking place, which may unwind a touch in Q3. But if our borders remain closed during the peak tourism season in summer, unseasonably weak prices are likely to come back with a vengeance.

- As expected, there was some residual strength in housing and household utilities, which were up 0.6% q/q (+0.1%pts). However, housing market fundamentals have changed, and that will weigh on prices eventually.

In some cases, these data have been affected significantly by lockdown-induced measurement issues (ie items not being traded and closed shops) and unusual pricing (ie free public transport). We expect Q3 will include a healthy dose of payback, but with underlying inflation continuing to decelerate.

Providing a minor offset, the recent minimum wage rise is likely to have boosted some prices a little more than otherwise in Q2, but with everything else that's going on this quarter it's difficult to untangle. Ultimately, minimum wage rises result in cost-push inflation. If implemented at a time when the labour market isn't tight enough to absorb it, this will generally result in weaker aggregate activity, employment, and medium-term inflation than otherwise. This small offset today is looking like it'll be a larger headache for the RBNZ tomorrow as it pulls out all stops to achieve its inflation and employment objectives.

Overall, despite the CPI coming in a touch stronger than we forecast, we got what we expected: A volatile read on quarterly inflation with evidence that there's more volatility to come. Looking through the noise, there's also confirmation here that the underlying inflation pulse is as weak as a kitten.

Figure 1. Headline CPI inflation

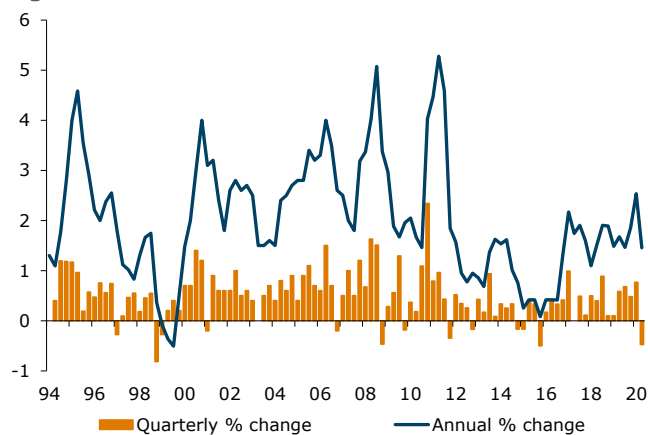


Figure 2. CPI inflation components

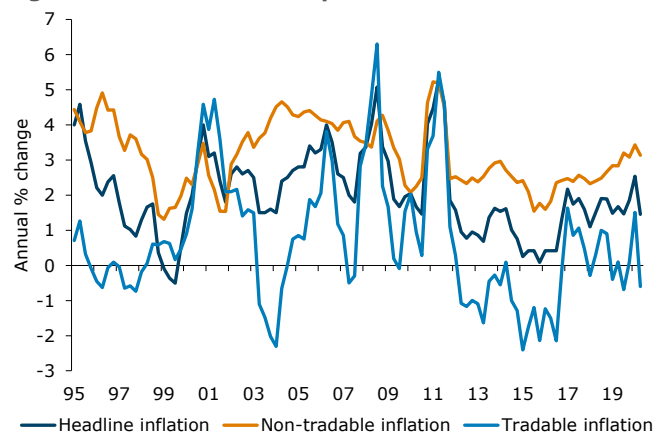


Figure 3. CPI groups – June 2020 quarter

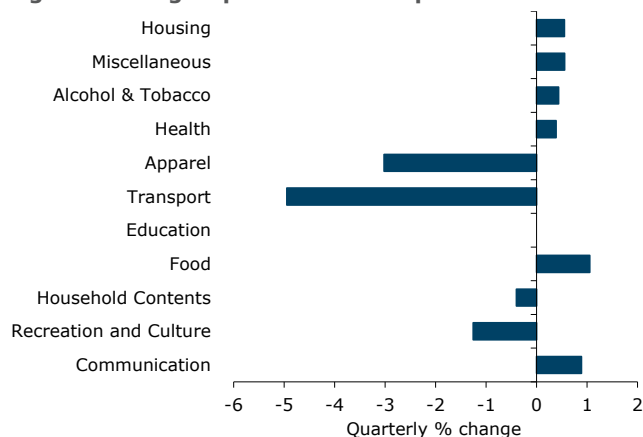
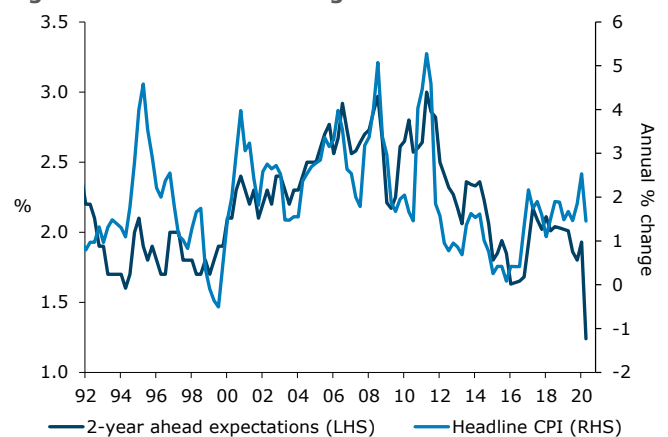


Figure 4. ANZ Inflation Gauge & non-tradables inflation



Source: Statistics NZ, RBNZ, ANZ Research



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