

June 2020 Quarter CPI Preview

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Weak, but noisy

Headline CPI is expected to have contracted 0.6% q/q in Q2, with annual inflation decelerating 1.1%pts to 1.4%. Lower petrol prices will weigh on tradable inflation. Residual strength in housing-related prices will put a floor under non-tradable inflation, but the weak demand outlook will sit on this eventually. Lockdown-induced noise will be a key feature and this won't wash out until Q4.

Key points

June quarter CPI figures will be released on Thursday (16 July).

We expect headline CPI contracted 0.6% q/q in Q2, which would mark the weakest quarterly read since Q4 1998 and see annual inflation decelerate a whopping 1.1% pts to 1.4% y/y. However, this is based on what we think we know about measured prices. [Lockdown-induced measurement issues, as well as methodological and price changes](#) are likely to make Q2 and Q3 very noisy, and also significantly widen the error band around our forecast.

We think there will be a few pockets of transitory weakness in the Q2 release on the back of low petrol prices and free public transportation during lockdown (the latter will bounce back sharply in Q3). However, this is unlikely to weigh on core inflation, which should moderate more gradually and remain closer to the 2% target midpoint for now.

Importantly, given measurement, timing and price volatility issues, a surprise in Q2 won't be a game-changer from a monetary policy perspective. Taking a broader view, we think it's clear that the inflation pulse is set to weaken markedly from here, and that the RBNZ has its work cut out:

- **Inflation expectations** for two years ahead hit a record low in June (1.24%). That should make the RBNZ very worried. When expectations become unanchored domestic inflation generally follows – this can be a very tough hole to climb out of.
- **The NZD-TWI** has depreciated just 2.0% in 2020, and is sitting a touch above its 2019 average of 72.52. If you were to ask us before COVID-19 hit what NZ's first line of defence is in a global crisis, a weaker NZD would have been near the top of that list. But despite the fact that NZ is a small open economy and the global backdrop is dire, we're also a relative "good news story" with robust export commodity prices and success in containing the virus – and that's in a world where global risk appetite has been remarkably buoyant. But while an elevated TWI might be explainable, there's no denying that it's resulting in tighter financial conditions than otherwise, and if persistent, will hinder the domestic recovery.
- **Weak global inflation** will weigh on world prices. This will be exacerbated by the elevated NZD, keeping tradable inflation very soggy.
- **The demand shock is just getting started.** Initially, this crisis included shocks to both supply and demand, meaning there's been some initial offset when it comes to price pressures. But as time goes on, supply disruption will pale in comparison to the hit to demand brought about by weaker household incomes and shaken confidence.
- **Conventional monetary policy has been exhausted.** QE is in full swing, [but more is needed](#). [The prospect of a negative OCR](#) is very real, but the jury isn't out on whether it will be helpful.

Consumers Price Index – June 2020 Quarter

	Expected	Prev
CPI – q/q	-0.6%	0.8%
CPI – y/y	1.4%	2.5%
Tradable – q/q	-1.1%	0.1%
Tradable – y/y	-0.5%	1.5%
Non-tradable – q/q	0.0%	1.4%
Non-tradable – y/y	3.1%	3.4%

Turning to the details of the Q2 release:

- A fall in petrol prices in the low teens will be a key driver of weak quarterly inflation. Plummeting global oil prices and the buoyed NZD have seen prices at the pump slip markedly. Free public transportation will drag, but prices will also bounce back strongly in Q3. Overall, the transport group is expected to drag on quarterly inflation to the tune of 0.95% points.
- Recreation and culture is also expected to drag (0.2%pts) led by unseasonably weak accommodation services (-6% q/q). It's the off season for international tourists, but the impact will still be significant.
- The Communication group is expected to recoil following Q1's strong rise in telecommunication equipment prices.
- Residual strength in housing and household utilities (up 0.9% q/q) is expected, but [housing market fundamentals have changed](#), and that will weigh on prices eventually. Rents will also soften in time on the back of rent freezes and higher inventories (reflecting fewer international visitors), but appear to have held up in Q2 (+1.0% q/q).
- Food prices are poised to rise a little more than is typical for a June quarter. This group has been particularly thrown around by lockdown, with restaurants closed and supermarkets doing a bumper trade.

Given the absence of policy implications, Q2 CPI is unlikely to garner a huge amount of market attention. Even core inflation measures will be discounted significantly given the noise in the data and what lies ahead. We expect headline inflation to sink below the 1-3% target band by year end. The RBNZ will need to keep its foot on the gas for a while yet.

Table 1. ANZ Q2 CPI component-level forecast

Groups	q/q%	%pt cont.
Food	1.1	0.21
Alcoholic beverages and tobacco	0.5	0.04
Clothing and footwear	0.7	0.03
Housing and household utilities	0.9	0.23
Household contents and services	0.6	0.03
Health	0.1	0.01
Transport	-7.1	-0.97
Communication	-1.0	-0.03
Recreation and culture	-1.9	-0.17
Education	0.2	0.00
Miscellaneous goods and services	0.8	0.07
Total	-0.6	-0.6

Figure 1. CPI inflation measures

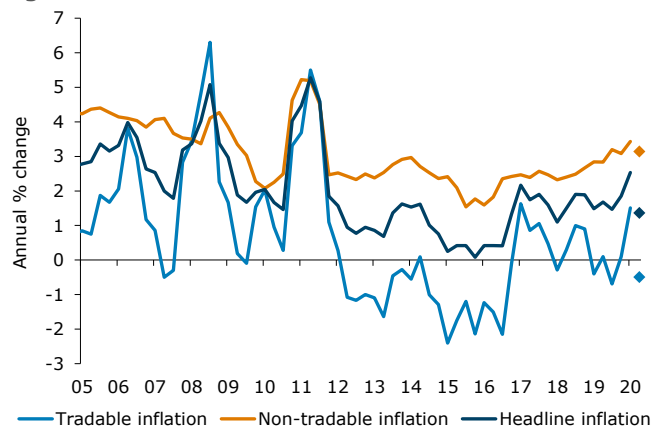
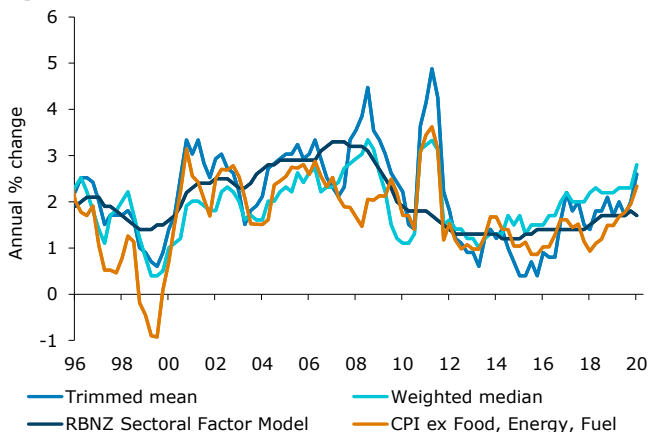
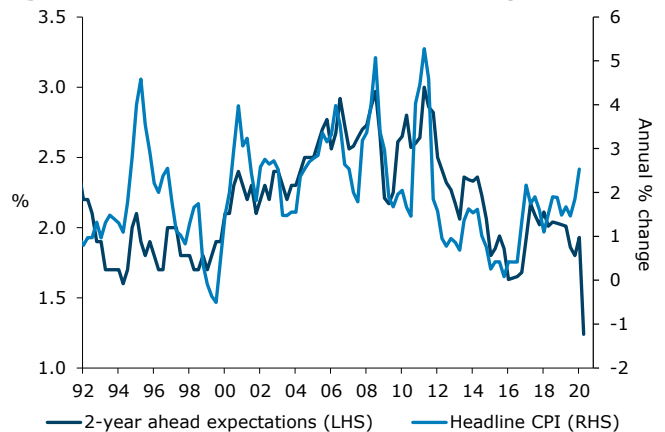


Figure 2. Selected core inflation measures



Source: Statistics NZ, RBNZ, ANZ Research

Figure 3. Headline inflation and inflation expectations





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