ANZ Research

March 2021 Quarter CPI Preview

15 April 2021

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False positive

The bottom line

We expect that CPI inflation rose 0.7% q/q (1.3% y/y) in Q1, weaker than the RBNZ's forecast of a 1.0% q/q rise. Supply chain disruptions, rising import costs, higher oil prices, and a booming housing market are all putting temporary upwards pressure on the prices consumers face. But the transitory nature of these drivers mean that the RBNZ is unlikely to be swayed from their watch, worry and wait stance.

Strength expected, but risks abound

March quarter CPI numbers are released on Wednesday 21st April.

We think that consumer prices rose 0.7% q/q (1.3% y/y) in the March quarter, up from 0.5% q/q (1.4% y/y) in Q4. A large portion of this rise appears to be coming from temporary global supply disruptions and oil price movements on the tradables side. This is unlikely to perturb the RBNZ, who will want to see more persistent signs of inflation momentum in the domestic economy.

There are lots of moving parts this quarter, so there is definitely scope for surprise. For one thing, it's hard to know the extent to which supply chain disruptions and capacity constraints in the economy will push prices higher.

At the same time, some CPI series are still well below pre-COVID levels. A prime example is footwear – it's usually a tiny part of the whole story, but footwear prices are way lower than this time last year. Should these prices rebound, the increase could be large enough to push overall inflation higher.

There are very real downside risks too. Some CPI groups demonstrated unseasonable strength in Q4, such as accommodation services and second-hand motor cars (summer road trips anyone?). This strength contributed to inflation surprising the market on the upside in Q4. These CPI components could be due a recoil, and while we have incorporated our own judgement to take account of this, again there's scope to be surprised if we've under- or over-cooked these impacts.

Add changes to tobacco excise taxes to the mix (see below), and you've got a CPI release that's going to be very difficult to interpret. The RBNZ will therefore be unlikely to take much from next week's numbers, even if they do come in above expectations.

Turning to the details

Of the 0.7% q/q rise in headline CPI in March:

- Petrol and other fuel prices are expected to contribute 0.2ppts to headline, with higher oil prices over the quarter expected to drive a 4.9% rise in fuel prices.
- Housing and household utilities are anticipated to add 0.2ppts. This largely reflects usual seasonal patterns, although robust rental prices and the booming housing market are also generating price pressure.

Consumers Price Index – March 2021 Quarter

	Expected	Prev
CPI – q/q	0.7%	0.5%
CPI – y/y	1.3%	1.4%
Tradable - q/q	0.5%	0.2%
Tradable - y/y	0.1%	-0.3%
Non-tradable - q/q	0.7%	0.7%
Non-tradable - y/y	2.1%	2.8%

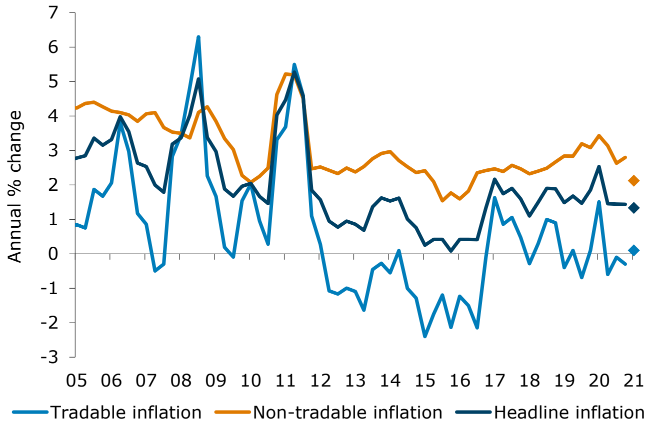
- The food price index rose 0.8% q/q, which should add 0.1ppts to headline CPI inflation. This is weaker than usual, but a retracement wasn't unexpected given the unusual strength in food prices at the end of 2020.
- Alcoholic beverages and tobacco should add 0.1ppts. This is a weaker-than-usual contribution (usually around 0.2-0.3ppts), reflecting the end to 10% annual tobacco excise tax hikes (see below).
- A broad range of other CPI groups make up the rest of the increase, with supply disruptions expected to permeate through a range of prices, propping up the headline CPI figure.

Table 1: ANZ Q1 CPI component-level forecast

Groups	q/q%	%pt cont.
Food	0.5	0.10
Alcoholic beverages and tobacco	1.0	0.09
Clothing and footwear	0.5	0.02
Housing and household utilities	0.7	0.23
Household contents and services	0.5	0.02
Health	0.2	0.01
Transport	0.6	0.17
Communication	-0.3	-0.01
Recreation and culture	-0.6	-0.04
Education	1.4	0.02
Miscellaneous goods and services	0.6	0.05
Total	**0.7**	**0.7**

Source: Statistics NZ, ANZ Research

Figure 1: CPI inflation measures

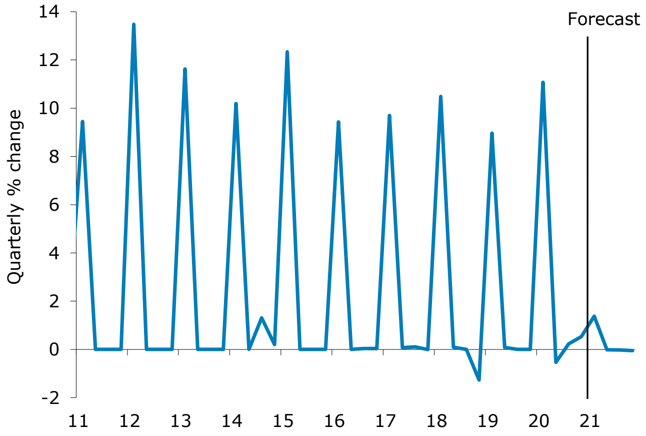


Tax changes will disguise quarterly strength

Administrative tax changes have complicated the inflation story this time around. Tax on tobacco products has changed from being raised 10% every March quarter (plus inflation in the previous year) to just increasing in line with inflation. Applying the new tax change to this CPI component over 2021 shows a much weaker outlook than previous years (figure 2). If taxes had continued to go up as much as previous years, our CPI pick would have been 1.0% q/q (figure 3). This is the same as the RBNZ's Q1 forecast in the February MPS, so it's unclear if they hadn't accounted for this tax change in their projection, or if they saw more inflation strength coming from other sources.

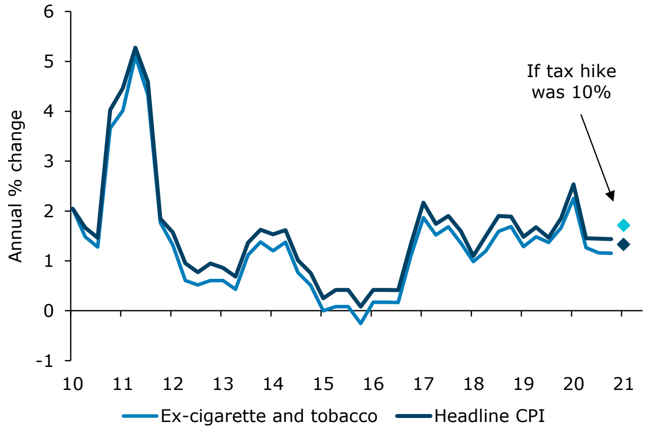
Regardless, while this sounds like a technical detail, the removal of this tax will actually make it harder for the RBNZ to meet its inflation target. Headline CPI would have been around 0.2-0.3ppts lower in recent years without this tax, and even then inflation was never sustainably at 2% over the post-GFC period. Without the annual bump from the tax hike, the RBNZ may need to support the economy for a long time to get inflation sustainably back to target.

Figure 2. Cigarettes and tobacco inflation



Source: Statistics NZ, Macrobond, ANZ Research

Figure 3. CPI inflation ex-cigarettes and tobacco

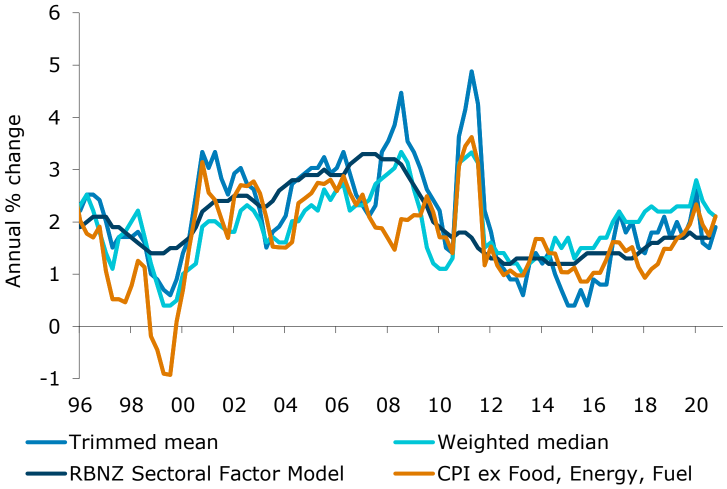


Policy implications

A strong quarterly CPI outturn next week will be unlikely to change the RBNZ's wait and see approach, although the data will be hard to interpret.

There're a lot of temporary factors pushing prices higher, so sorting the supply disruption noise from any genuine signal of stronger inflation will be difficult. Usually we can turn to measures of core inflation to get a better sense of the 'true' inflationary impulse underlying the data. These measures are great (although not perfect) at removing the effects of a volatile series, for example if oil prices spike (figure 4).

Figure 4. Core CPI inflation measures



Source: Statistics NZ, ANZ Research

However, supply chain disruptions and capacity constraints in some industries are not easily stripped out in core measures. Transitory inflation pressures could cause core inflation measures to lift, but that's not to say this upward momentum will prove persistent. Caution is warranted when interpreting these data.

Of course, there is the risk that all these supply pressures and rising costs do bleed through into broader price-setting behaviour, and become embedded in higher inflation expectations. This could put the RBNZ in an uncomfortable position with inflation pushing above their target band much sooner and for longer than expected, and this could see them facing a trade-off between keeping inflation contained and supporting the labour market.

But the bottom line is that the economic damage from COVID-19 still represents a pretty significant income shock (one that's been partially transferred to the future by loading up on debt), and that points to a still fragile underlying demand pulse over the medium term. But in the near term we see temporary supply chain disruptions, closed borders, and labour market mismatch issues keeping inflation buoyant. But, eventually when borders open and supply issues start to subside, we may be faced with an economy that's continuing to struggle with residual capacity (ie a negative output gap). So for the RBNZ, it'll be a pretty high hurdle for next week's inflation outturn to challenge their wait and see stance.

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