ANZ Research

June 2021 Quarter CPI Preview

13 July 2021

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Consumers Price Index – June 2021 Quarter

	Expected	Prev
CPI – q/q	0.9%	0.8%
CPI – y/y	3.0%	1.5%
Tradable - q/q	1.0%	0.9%
Tradable - y/y	2.7%	0.5%
Non-tradable - q/q	0.9%	0.7%
Non-tradable - y/y	2.9%	2.1%

Top of the band

The bottom line

We expect that CPI inflation rose 0.9% q/q (3.0% y/y) in Q2, touching the top of the RBNZ's target band of 1-3%, and well-above the May MPS forecast of a 2.6% y/y rise in prices in the year to June. Supply chain disruptions are showing no signs of easing, the labour market is tightening, and firms are starting to pass higher costs onto consumers (with little pushback). That's a pretty potent mix for strong inflation over 2021 (and beyond, without imminent OCR hikes).

Some transitory, some persistent, and some sustained

June quarter CPI numbers are released on Friday 16th July, just two days after the RBNZ's Monetary Policy Review.

We think that consumer prices rose 0.9% q/q (3.0% y/y) in the June quarter, up from 0.8% q/q (1.5% y/y) in Q1 (figure 1). As we've moved through 2021, transitory inflation pressures have started to look more persistent (although not necessarily permanent). And there are signs that some inflation pressures will be more sustained, especially with the labour market likely at (or close to) full employment.

This week's CPI data will likely contain a hodgepodge of these transitory, persistent, and more sustainable factors. On the transitory side, oil prices continued to increase over the June quarter, which has a direct impact on the prices that Kiwis pay at the pump. The minimum wage was increased to $20/hr in April. And, the annual calculation (ie y/y % change) is compared with Q2 2020 – when prices fell on a quarterly basis. All of these factors will give the headline inflation figure a boost compared with the underlying inflation impulse. It's worth noting that even if quarterly inflation was *zero*, annual CPI inflation would still be 2.0% y/y – that's the power of base effects!

On the persistent side, the myriad of supply chain disruptions brought on by COVID-19 are showing no signs of easing any time soon. Shipping costs continue to increase, and delays at ports are making physical goods and materials more scarce (and therefore more expensive). There will inevitably be some payback from these cost increases (ie falling prices) – they are a symptom of the unique times we're all living through after all. But this payback is looking like it'll take a while to come around.

Then we get to the more sustainable sources of inflation pressure, namely the very tight labour market, changes in pricing behaviour by firms, and rising inflation expectations. With the labour market already within cooee of full employment, and the border still closed, we expect to see considerable wage pressures developing, starting in Q2 (although we won't know for sure until the labour market data are released on 4 August). Combine a tight labour market with the increased cost of getting stuff into the country, and that's seen massive cost increases for firms.

Rising costs for firms are not actually enough to get consistently higher inflation (it's the Consumers Price Index after all). You also need firms to pass on higher costs to consumers (something that was somewhat lacking prior to COVID-19). But it looks like firms have been doing just that – with pricing intentions in the ANZ Business Outlook skyrocketing (especially in retail), and anecdotal evidence from ANZecdotes indicating that firms aren't experiencing much pushback from higher prices. All up, that speaks to higher inflation expectations, which means that higher inflation could become more embedded in price and wage setting behaviour. In fact, the ANZ Business Outlook suggests inflation expectations may be starting to get a tad too high to be comfortable for the RBNZ (figure 3).

Combining all these factors together, we're looking at very strong inflation in Q2, and for the rest of the year. And without OCR hikes (which we think will start in November), it's easy to see inflation starting to get a little out of hand.

Turning to the details

Of the 0.9% q/q rise in headline CPI in the June quarter:

- Petrol and other fuel prices are expected to contribute 0.2ppts to headline, with weekly petrol data suggesting a 4.4% rise in fuel prices over the quarter.
- Housing and household utilities are anticipated to add 0.4ppts. Extremely strong house price inflation and surging construction sector pricing intentions in the ANZ Business Outlook suggest that there's a lot of inflation coming from the hot housing market. And this may last for some time – even though we're consenting record levels of new dwellings, it could still take years to clear the housing shortage (even if the border remains closed).
- Strong food price inflation is expected to add 0.3ppts to headline CPI inflation. With global commodity prices rising sharply in recent months, food prices have not escaped these increases. Seasonal rises in vegetable prices, the April minimum wage rise, and the ongoing labour shortage have also likely put pressure on food prices.

Policy implications

This will be a key data point for the RBNZ (and economists trying to forecast when interest rates will rise!). We've seen some incredibly encouraging data prints in recent months, with GDP up a stonking 1.6% q/q in Q1, job vacancies smashing records, and business surveys (ANZBO and QSBO) all pointing to an economy that's red hot. But, this will be the first print where we see how all these pressures are starting to feed through into prices.

We're expecting to see the highest inflation since the GFC (excluding the GST hike). If inflation does come in as expected, then the case for a November hike (if not earlier) will be looking very strong. Of course, the drivers of inflation matter – the RBNZ isn't going to hike interest rates just because oil prices went up a bunch. But as we discuss above, when we cut through the noise of higher oil prices, minimum wage hikes, base effects, and persistent supply disruptions, we are seeing signs of sustained underlying inflation pressure. The labour market is tight, businesses are passing on higher costs, and consumers are expecting strong price increases – that's all a recipe for sustained inflation pressure.

Measures of core inflation should provide an indication of the underlying inflation impulse in Friday's data. While there's always the possibility that COVID-related volatility could trip these models up, further increases in these measures would only add to the pile of evidence that this economy is running hot. In Q1 the RBNZ's sectoral-factor model increased to 1.9% y/y, with tradables and non-tradables at or close to post-GFC highs (figure 2). Another uptick in Q2 would be hard to look through.

Table 1. ANZ Q2 CPI component-level forecast

	q/q%	%pt cont.
Food	1.5	0.28
Alcoholic Beverages & Tobacco	0.5	0.04
Clothes & Footwear	1.2	0.05
Housing & Household Utilities	1.4	0.42
Household Contents & Services	1.2	0.05
Health	0.2	0.01
Transport	0.6	0.08
Communication	-1.4	-0.04
Recreation & Culture	-0.1	-0.01
Education	0.1	0.00
Miscellaneous Goods & Services	0.5	0.04
Total	**0.9**	**0.93**

Figure 1. CPI inflation measures

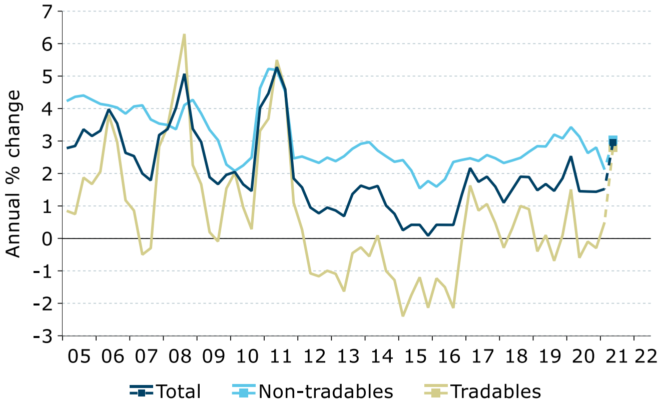


Figure 2. Sector-factor model inflation

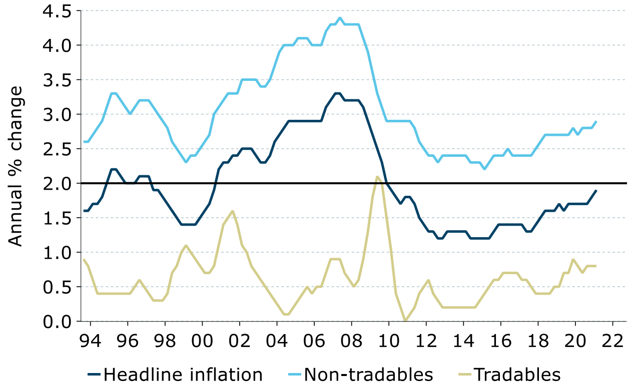
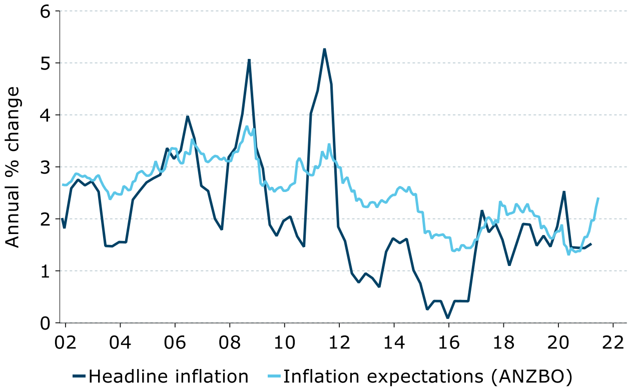


Figure 3. Headline inflation and inflation expectations



Source: Statistics NZ, RBNZ, Macrobond, ANZ Research

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