ANZ Research

September 2021 Quarter CPI Preview

13 October 2021

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Contact

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Consumers Price Index – September 2021 Quarter

	Expected	Prev
CPI – q/q	1.8%	1.3%
CPI – y/y	4.5%	3.3%
Tradable - q/q	2.4%	1.7%
Tradable - y/y	5.3%	3.4%
Non-tradable - q/q	1.5%	1.2%
Non-tradable - y/y	4.1%	3.3%

Close to the peak?

The bottom line

We expect that consumer prices increased 1.8% q/q (4.5% y/y) in the September quarter, up from 1.3% q/q (3.3% y/y) in Q2. There are still a lot of one-off and 'temporary but persistent' factors pushing up prices, but more concerning for the RBNZ will be the strength evident in underlying inflation pressures. A strong reading for core inflation next week may increase the RBNZ's conviction (and market pricing) for near-term OCR hikes, but downside risks to growth and employment certainly aren't going away, and delivering ongoing hikes may be no simple matter. As we head into the Christmas rush, pressure on already-stretched supply chains means we may not see inflation peak until the New Year – a bit later than we previously thought.

The view

CPI inflation figures for the September quarter are released on 18 October next week.

We're forecasting that consumer prices rose 1.8% q/q (4.5% y/y) in the September quarter, up from an already-strong 1.3% q/q (3.3% y/y) increase in the June quarter. Underlying inflation pressure is undoubtedly very strong right now – although there are many temporary factors going into the mix that are propping up headline inflation. These factors include council rates rises, surging petrol prices, and seasonal peaks in food prices.

Supply disruptions continue to be a major theme – and while we still see these as being persistent, not permanent, the risk is that the cost increases coming from this disruption seep into general price and wage setting behaviour, generating a wage-price spiral. These disruptions are probably going to become more acute as we move into the Christmas season, and retailers around the world rush to secure inventory for the incoming spending spree.

Of more concern for the RBNZ, and one of the key reasons for hiking the OCR last week, is the broad underlying inflation impulse that is building. Of the roughly 60 CPI series that make up our bottom-up forecast, only a handful are expected to drop in Q3 – and those mostly due to seasonal factors. Combined with a very tight labour market, already too-high core inflation, and firms and households all expecting higher inflation, next week's inflation data should reinforce the RBNZ's belief that they did the right thing in raising interest rates, despite much of the country being in lockdown for an indeterminate period.

Breaking down the 1.8% q/q rise in headline CPI in the September quarter:

- **Food prices** are expected to add 0.5ppts to headline inflation. Food prices are usually higher during the middle of the year, especially for fruit and vegetables. But we've seen prices lift by even more than usual over the middle of 2021, reflecting labour shortages, the minimum wage hike, increased costs from COVID-related disruptions, and higher food prices across the globe as extreme weather events impacted harvests from Europe to the US and China.

- **Petrol and other fuel prices** are expected to contribute 0.3ppts to headline. Oil prices collapsed when COVID first struck in 2020, but with economies starting to recover and reopen over 2021, oil prices have surged – and that's turned up directly in petrol prices. While temporary surges in petrol prices aren't something the RBNZ usually worries about too much (as they don't tend to impact longer-term inflation expectations), this increase will make the headline CPI figure look even more concerning, and, since petrol is a necessity a lot of the time, will make it even tougher on household budgets.
- Price pressures in **housing** showed no signs of easing in Q3, and we expect this added 0.6ppts to headline inflation. Rents continue to grind higher, adding 0.1ppts to headline inflation. And construction costs are through the roof – expected to add 0.2ppts to inflation as demand for new housing remained very strong over the September quarter, while labour and materials shortages continued to plague the building industry. Annual council rates increases also came into effect this quarter – with rates up around 7% on average across the country – that should add an additional 0.2ppts to headline inflation.
- **Supply disruptions** have been a continued theme over the past year, creating delays and adding huge cost increases. It's hard to quantify the impact of these disruptions on CPI inflation, but if Q2's inflation data was anything to go by, COVID has been a broad-based supply shock, with strong price increases across most major tradable components. In addition to the factors already listed in previous bullet points, about 0.3ppts of our forecast reflects strength across a range of imported goods prices, including household appliances, tools, textiles, clothing and footwear. It's not an exact science. But in September 84% of firms (87% of retailers) reported higher costs. They're going to have to pass some of that on.
- The final 0.1ppts consist of **broad-based price rises** across most other groups in the CPI (table 1).

Monetary policy implications

A major shift since the last inflation data three months ago is that the RBNZ has increased the OCR from 0.25% to 0.5%, and has signalled that, all going well, they will continue to remove the emergency stimulus deployed over 2020. Part of the rationale for this is that underlying inflation has increased to the point where the RBNZ is more worried about overshooting its targets than undershooting – a stark reversal from 2020 when most forecasters (including us) expected a protracted and deflationary recession due to COVID. At face value, we expect that Q3's inflation data will only reinforce the appropriateness of this removal of stimulus. In Q2, the RBNZ's sectoral factor model of core inflation increased above 2% for the first time since the GFC – and further increases would likely make the RBNZ more confident that emergency stimulus measures need to be removed.

But the balance of risks is actually looking pretty uncomfortable. Early indications are that employment was robust over the first few weeks of lockdown. But with lockdown dragging on (and cases trending up), downside risks to employment and growth must inevitably be building, for all that investment and employment intentions have so far proven resilient. At the same time, inflation risks are very much to the upside. With Christmas demand only adding stress to already creaking global supply chains and energy prices surging around the world, it's looking more likely that annual CPI inflation may not peak until the New Year.

These inflation figures may sound pretty disheartening, especially considering we're currently only forecasting a 4.2% y/y increase in average hourly earnings over the September quarter (ie slightly negative real wage growth). But we're confident that all going well, the RBNZ will be able to quickly rein in inflation pressure with a series of gradual OCR hikes over the next year. Household debt is high and rising interest rates will get traction, undoubtedly. The COVID-related price rises we've seen won't last forever, and once supply chain congestion starts to ease, some prices may fall. Of course, the timing and magnitude of this normalisation is impossible to accurately forecast.

When you add a central bank removing stimulus to COVID disruption easing, the medium-term outlook for inflation in New Zealand is more benign than the rather alarming headline numbers would suggest. If the RBNZ were to stand idly by, the risk of a wage-price spiral would be considerable, but that isn't our forecast. The challenge for the RBNZ is that the longer the current Delta outbreak in New Zealand lasts, the more downside risk to growth and employment builds, while price pressures continue to rise.

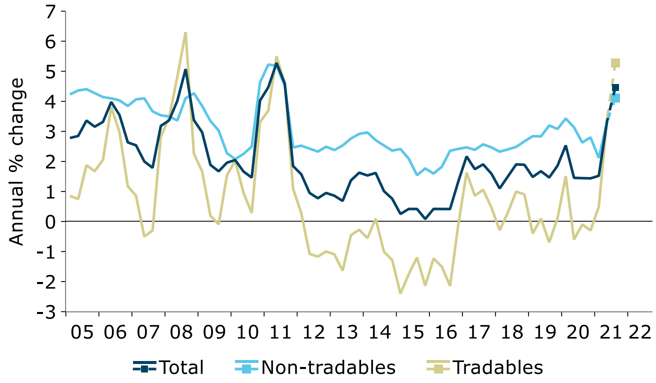
Table 1. ANZ Q3 CPI component-level forecast

	q/q%	%pt cont.
Total	**1.8**	**1.79**
Housing & Household Utilities	1.8	0.57
Food	2.5	0.49
Transport	3.1	0.40
Recreation & Culture	1.3	0.11
Household Contents & Services	2.1	0.09
Clothes & Footwear	2.0	0.08
Miscellaneous Goods & Services	0.6	0.05
Health	0.6	0.02
Alcoholic Beverages & Tobacco	0.2	0.01
Education	0.5	0.01
Communication	-2.1	-0.05

■ Quarterly % change ■ Percentage point contribution

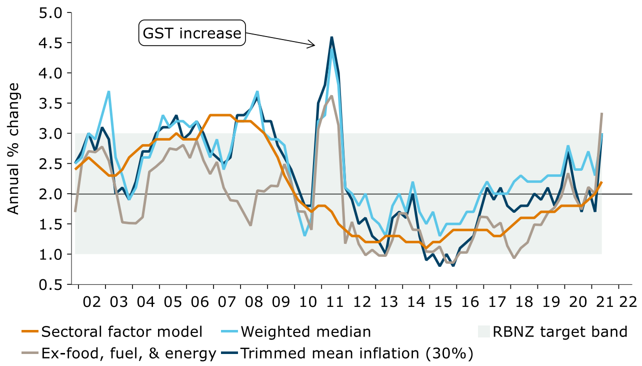
Source: Stats NZ, Macrobond, ANZ Research

Figure 1. CPI inflation measures



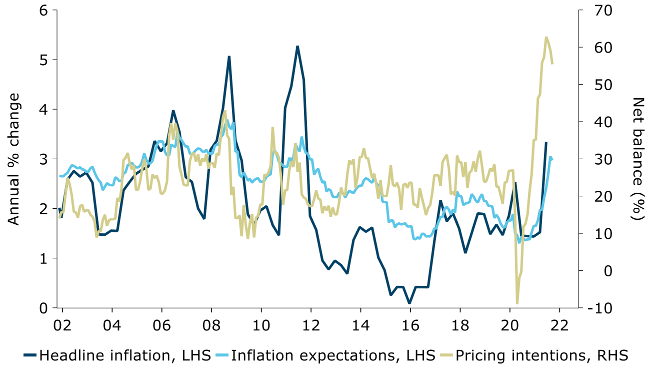
Source: Stats NZ, Macrobond, ANZ Research

Figure 2. Core inflation measures



Source: Stats NZ, RBNZ, Macrobond, ANZ Research

Figure 3. CPI inflation and ANZBO inflation measures



Source: Stats NZ, Macrobond, ANZ Research

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