ANZ Research

CPI Preview and Forecast Update

15 January 2021

This is not personal advice. It does not consider your objectives or circumstances. Please refer to the Important Notice.

Contact

Liz Kendall for more details.

Better inflation outlook but weak starting point – easing bias remains appropriate

CPI is expected to have been weak in Q4 2020, which is usual for that time of year. We expect CPI lifted 0.3% q/q, with annual inflation dipping from 1.4% y/y to 1.2% following modest prints in recent quarters. Looking forward, cost pressures from supply disruptions will boost inflation, though this is expected to prove temporary and the RBNZ will look through it. We expect a temporary lift in inflation to above 2% mid-2021, followed by a retracement into 2022.

Headwinds from the high TWI and low inflation expectations will be slow to dissipate, but the outlook for inflation over the medium term is now looking more assured, and we have updated our forecasts to reflect this. The outlook for demand is looking better and inflation expectations are on the rise, meaning a persistent lift is looking more achievable. It will be a slow grind higher, but inflation pressures look set to build, with a return to target by mid-2023.

Recent developments reduce the urgency for monetary stimulus, with risks now less clearly skewed to the downside. We now expect the RBNZ to cut the OCR to 0.1% in May then hold thereafter. Although there is less need for stimulus, downside risks to the inflation outlook remain a concern and the RBNZ will remain vigilant and poised to act if required. That means continued dovish rhetoric, an easing bias, and an expansionary stance of monetary policy for a long while yet.

The view

A more positive medium-term outlook

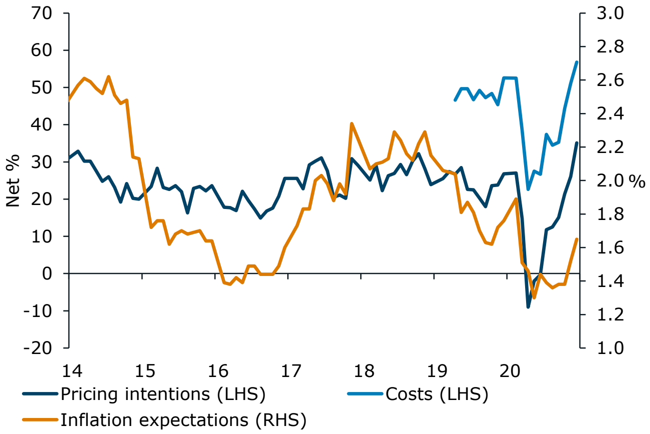
We have updated our inflation forecasts, reflecting a range of developments. These result in a stronger, more assured medium-term outlook, but headwinds remain and inflation will take some time to return to target comfortably.

- **A weak starting point:** We expect that CPI rose 0.3% in Q4, implying annual inflation of a mere 1.2% y/y. Q4 is usually a weak quarter, with seasonal falls in food and grocery prices contributing. But there are some pockets of domestic price increases too (see page 3 for details). This is a touch above the RBNZ's November MPS forecast (0.2% q/q; 1.1% y/y).
- **Supply disruptions:** Cost pressures are evident, leading to pockets of price increases in the near term at least. At this stage we do not expect this to result in significant generalised inflation (and the RBNZ will look through transitory impacts). But inflation expectations are starting to lift from recent lows, especially on the back of cost increases (figure 1). We think these will continue to creep higher, supporting medium-term inflation, and reducing RBNZ concerns about low inflation becoming entrenched.
- **A higher exchange rate:** The NZD has pushed higher, up 5% over the course of Q4. This reflects our strong domestic story, but will weigh on prices nonetheless. Combined with an economic wobble early in 2021 and a low starting point for inflation expectations, this will be a headwind to inflation.
- **Stronger demand:** We expect that the economic recovery will become more challenging early this year, but the rebound so far is nothing short of spectacular, meaning there is less slack in the economy than previously feared. Over the medium term, as spare capacity is eventually absorbed, that means less unemployment and less downward pressure on inflation.

Consumers Price Index – December 2020 Quarter

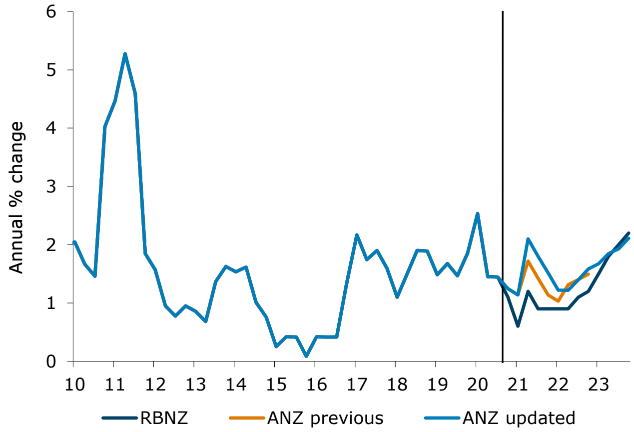
	Expected	Prev
CPI – q/q	0.3%	0.7%
CPI – y/y	1.2%	1.4%
Tradable - q/q	-0.4%	0.6%
Tradable - y/y	-0.9%	-0.1%
Non-tradable - q/q	0.7%	0.6%
Non-tradable - y/y	2.8%	2.6%

Figure 1. ANZBO pricing indicators



Source: ANZ Research

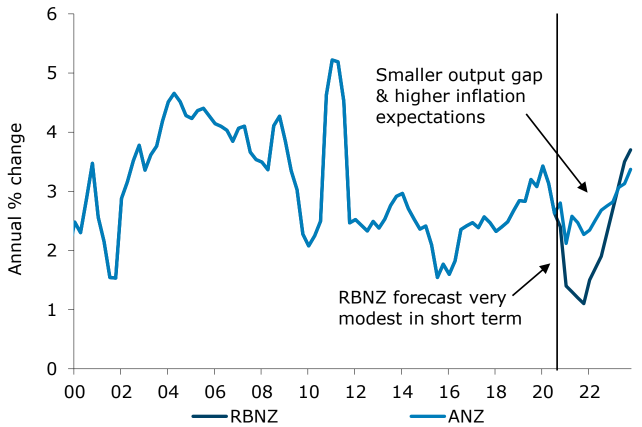
Figure 2. Inflation forecasts – ANZ and RBNZ



Source: Stats NZ, RBNZ, ANZ Research

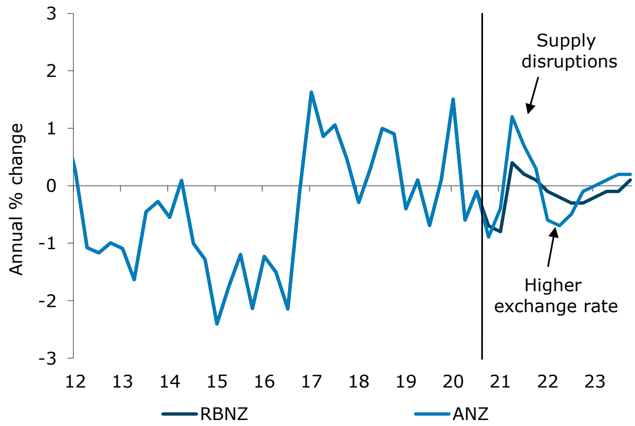
Our revised CPI outlook is slightly stronger than the RBNZ's November MPS forecasts (figure 2). However, the outlook for domestic inflation – which the RBNZ cares most about – is meaningfully stronger (figure 3). This reflects our view that there is less spare capacity in the economy than the RBNZ is assuming and that inflation expectations will be less of a drag. Conversely, we are assuming a weaker profile for tradable inflation than the RBNZ, partly due to the higher NZD (figure 4). Developments clearly point to a stronger domestic inflation picture and we expect the RBNZ will revise up their forecasts for inflation at the February MPS. However, they will likely remain cautious in their assumptions, especially in the short term, meaning we expect to see a profile that is weaker than our own.

Figure 3. Non-tradable inflation – ANZ and RBNZ



Source: Stats NZ, RBNZ, ANZ Research

Figure 4. Tradable inflation – ANZ and RBNZ



Source: Stats NZ, RBNZ, ANZ Research

Risks in both directions

Risks to the inflation outlook now appear to be less clearly skewed to the downside than previously. Because inflation is so low already, downside inflation risks remain more problematic for the RBNZ than upside ones. But the trend towards higher inflation expectations has taken the pressure off to some degree. Although inflation is set to remain low for a long while, risks are receding that even lower inflation becomes entrenched.

Downside risks to the GDP outlook are ever-present, of course, and the RBNZ are conscious of this. Our fortunes could turn on a dime if COVID were to return to our shores. But the bounce that we have seen in activity has been impressive, and is expected to set households and firms up to manage some stagnation in the economic recovery as our lost summer of tourism is felt.

There are also more reasons to be conscious of upside risks, which could conceivably see inflation even stronger than we are currently forecasting. At this stage we are assuming that cost pressures do not pass though into widespread inflation. This seems a reasonable assumption, given that pressures so far appear concentrated in certain pockets and there are other offsetting headwinds. But to the extent that cost pressures spill over more widely and lead to upward pressure on inflation expectations, this could pose upside risk.

Yet it is very difficult to imagine an environment where the recent low inflation dynamic changes abruptly. The global economic environment is challenging, inflation expectations are low and the NZD continues its upward march – all of these headwinds are expected to weigh on the inflation outlook and could prove more of a battle to offset than expected.

Policy implications

The outlook for medium-term inflation is now looking more assured, and that will take the pressure off the RBNZ to provide more monetary stimulus. There is less spare capacity in the economy, inflation expectations are on the rise and risks are less clearly skewed to the downside – giving the RBNZ scope to pause and see how developments unfold. Inflation pressures look set to build and see CPI inflation return to target more comfortably over the forecast horizon.

But it will take some time for this improvement to manifest and downside risks remain a concern, meaning the RBNZ has good reason to remain wary about the outlook. Inflation looks set to be low over the coming year, given the weak starting point, meaning continued dovish rhetoric from the RBNZ will be justified beyond the final 15bp OCR cut we are forecasting in May.

The RBNZ will want to be assured that inflation is close to target before contemplating policy normalisation and it won't be until 2022 that we will see that manifest. In that environment, it is hard to imagine interest rates going higher any time soon. Until an improvement in inflation is finally seen, risks will remain skewed towards interest rates going lower, not higher – and the RBNZ will continue to reiterate a willingness to do more if required. That means an easing bias and stimulatory stance of policy for a long while yet.

Although New Zealand is charting its own course and the RBNZ will set policy for the domestic economy, some of the same themes are evident in other economies. Globally, expectations for inflation have been trending higher (based on market pricing, for example), but this upwards trend has been from a very low base. There is a widespread desire amongst central banks to keep policy stimulatory until inflation at (or even above) target is evident. The recent increase in expectations will be a relief for central banks, taking pressure off them to provide even more stimulus – but that's a far cry from motivating an imminent move towards policy normalisation, especially with the economic outlook still dire in many places. It's all a recipe for interest rates remaining low for a long while yet.

2020Q4 CPI – the details

December quarter CPI figures will be released on Friday 22 January. Tradable prices are expected to fall 0.4% q/q (-0.9% y/y), while non-tradable prices are expected to lift 0.7% q/q to tick up from 2.6% to 2.8% y/y. Core inflation measures are expected to remain muted.

Of the 0.3% q/q increase in headline CPI:

- Food prices and alcoholic beverage prices are usually a drag in the December quarter and this time is no exception, subtracting 0.30%pts.
- Transport is expected to contribute 0.1%pt, with used car and air travel prices seeing some upward pressure, while petrol prices fell.
- Housing and related prices are expected to have contributed 0.2%pts, with construction costs rising.

- Recreational and cultural prices are expected to contribute 0.25%pts. Accommodation prices will see seasonal strength (+10.3%), partially retracing declines earlier in the year to still be below pre-COVID levels.
- Other miscellaneous prices are expected to be a bit higher than usual, with less discounting for clothing, footwear and some durables. There are also seasonal price increases expected for insurance and some other services. All of this totals roughly 0.1%pt.

Table 1. ANZ Q4 CPI component-level forecast

Groups	q/q%	%pt cont.
Food	-1.8	-0.28
Alcoholic beverages and tobacco	-0.6	-0.04
Clothing and footwear	0.5	0.02
Housing and household utilities	0.6	0.20
Household contents and services	0.1	0.01
Health	0.3	0.01
Transport	1.4	0.10
Communication	-1.3	-0.03
Recreation and culture	3.4	0.24
Education	0.1	0.00
Miscellaneous goods and services	0.7	0.06
Total	**0.3**	**0.3**

Figure 5. CPI inflation measures

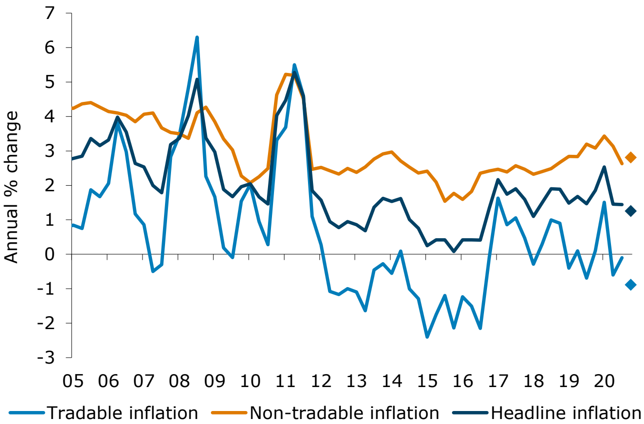


Figure 6. Selected core inflation measures

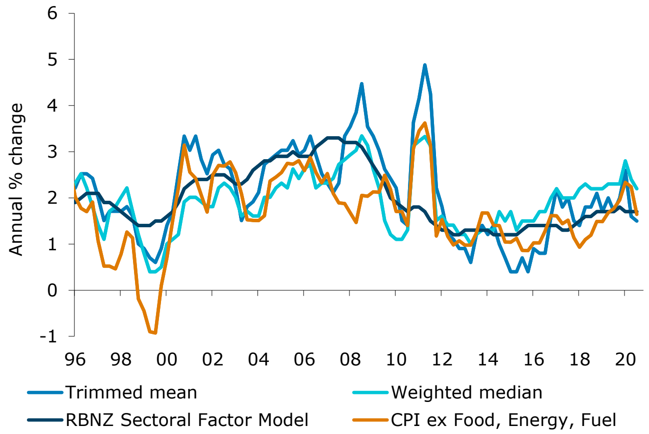
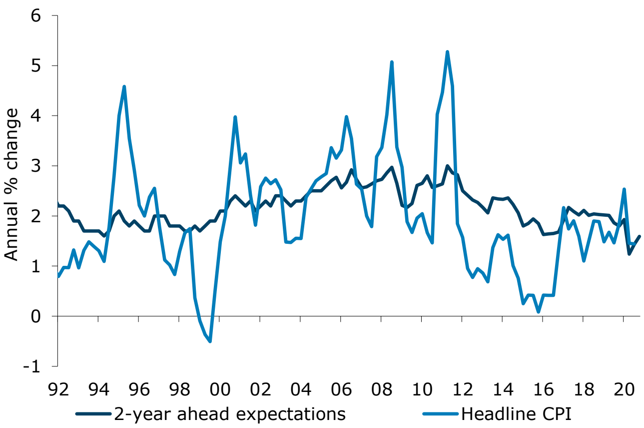


Figure 7. Headline inflation and inflation expectations



Source: Statistics NZ, RBNZ, ANZ Research

Contact us

Meet the team

We welcome your questions and feedback. Click here for more information about our team.

Sharon Zollner
Chief Economist

Follow Sharon on Twitter
@sharon_zollner

Telephone: +64 27 664 3554
Email: sharon.zollner@anz.com

General enquiries:
research@anz.com

Follow ANZ Research
@ANZ_Research (global)

David Croy
Senior Strategist

Market developments, interest rates, FX, unconventional monetary policy, liaison with market participants.

Telephone: +64 27 432 2769
Email: david.croy@anz.com

Susan Kilsby
Agricultural Economist

Primary industry developments and outlook, structural change and regulation, liaison with industry.

Telephone: +64 21 633 469
Email: susan.kilsby@anz.com

Liz Kendall
Senior Economist

Research co-ordinator, publication strategy, property market analysis, monetary and prudential policy.

Telephone: +64 27 240 9969
Email: elizabeth.kendall@anz.com

Miles Workman
Senior Economist

Macroeconomic forecast co-ordinator, fiscal policy, economic risk assessment and credit developments.

Telephone: +64 21 661 792
Email: miles.workman@anz.com

Kyle Uerata
Economic Statistician

Economic statistics, ANZ proprietary data (including ANZ Business Outlook), data capability and infrastructure.

Telephone: +64 21 633 894
Email: kyle.uerata@anz.com

Natalie Denne
PA / Desktop Publisher

Business management, general enquiries, mailing lists, publications, chief economist's diary.

Telephone: +64 21 253 6808
Email: natalie.denne@anz.com

Important notice

This document is intended for ANZ's Institutional, Markets and Private Banking clients. It should not be forwarded, copied or distributed. The information in this document is general in nature, and does not constitute personal financial product advice or take into account your objectives, financial situation or needs.

This document may be restricted by law in certain jurisdictions. Persons who receive this document must inform themselves about and observe all relevant restrictions.

Disclaimer for all jurisdictions: This document is prepared and distributed in your country/region by either: Australia and New Zealand Banking Group Limited (ABN11 005 357 522) (**ANZ**); or its relevant subsidiary or branch (each, an **Affiliate**), as appropriate or as set out below.

This document is distributed on the basis that it is only for the information of the specified recipient or permitted user of the relevant website (**recipients**).

This document is solely for informational purposes and nothing contained within is intended to be an invitation, solicitation or offer by ANZ to sell, or buy, receive or provide any product or service, or to participate in a particular trading strategy.

Distribution of this document to you is only as may be permissible by the laws of your jurisdiction, and is not directed to or intended for distribution or use by recipients resident or located in jurisdictions where its use or distribution would be contrary to those laws or regulations, or in jurisdictions where ANZ would be subject to additional licensing or registration requirements. Further, the products and services mentioned in this document may not be available in all countries.

ANZ in no way provides any financial, legal, taxation or investment advice to you in connection with any product or service discussed in this document. Before making any investment decision, recipients should seek independent financial, legal, tax and other relevant advice having regard to their particular circumstances.

Whilst care has been taken in the preparation of this document and the information contained within is believed to be accurate, ANZ does not represent or warrant the accuracy or completeness of the information Further, ANZ does not accept any responsibility to inform you of any matter that subsequently comes to its notice, which may affect the accuracy of the information in this document.

Preparation of this document and the opinions expressed in it may involve material elements of subjective judgement and analysis. Unless specifically stated otherwise: they are current on the date of this document and are subject to change without notice; and, all price information is indicative only. Any opinions expressed in this document are subject to change at any time without notice.

ANZ does not guarantee the performance of any product mentioned in this document. All investments entail a risk and may result in both profits and losses. Past performance is not necessarily an indicator of future performance. The products and services described in this document may not be suitable for all investors, and transacting in these products or services may be considered risky.

ANZ expressly disclaims any responsibility and shall not be liable for any loss, damage, claim, liability, proceedings, cost or expense (Liability) arising directly or indirectly and whether in tort (including negligence), contract, equity or otherwise out of or in connection with this document to the extent permissible under relevant law. Please note, the contents of this document have not been reviewed by any regulatory body or authority in any jurisdiction.

ANZ and its Affiliates may have an interest in the subject matter of this document. They may receive fees from customers for dealing in the products or services described in this document, and their staff and introducers of business may share in such fees or remuneration that may be influenced by total sales, at all times received and/or apportioned in accordance with local regulatory requirements. Further, they or their customers may have or have had interests or long or short positions in the products or services described in this document, and may at any time make purchases and/or sales in them as principal or agent, as well as act (or have acted) as a market maker in such products. This document is published in accordance with ANZ's policies on conflicts of interest and ANZ maintains appropriate information barriers to control the flow of information between businesses within it and its Affiliates.

Your ANZ point of contact can assist with any questions about this document including for further information on these disclosures of interest.

Country/region specific information: Unless stated otherwise, this document is distributed by Australia and New Zealand Banking Group Limited (**ANZ**).

Australia. ANZ holds an Australian Financial Services licence no. 234527. For a copy of ANZ's Financial Services Guide please click here or request from your ANZ point of contact.

Brazil, Brunei, India, Japan, Kuwait, Malaysia, Switzerland, Taiwan. This document is distributed in each of these jurisdictions by ANZ on a cross-border basis.

Cambodia. This document is distributed in Cambodia by ANZ Royal Bank (Cambodia) Limited (**ANZ Royal Bank**). The recipient acknowledges that although ANZ Royal Bank is a subsidiary of ANZ, it is a separate entity to ANZ and the obligations of ANZ Royal Bank do not constitute deposits or other liabilities of ANZ and ANZ is not required to meet the obligations of ANZ Royal Bank.

European Economic Area (EEA): *United Kingdom.* ANZ is authorised in the United Kingdom by the Prudential Regulation Authority (**PRA**) and is subject to regulation by the Financial Conduct Authority (**FCA**) and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request. This document is distributed in the United Kingdom by Australia and New Zealand Banking Group Limited ANZ solely for the information of persons who would come within the FCA definition of "eligible counterparty" or "professional client". It is not intended for and must not be distributed to any person who would come within the FCA definition of "retail client". Nothing here excludes or restricts any duty or liability to a customer which ANZ may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the Prudential Regulation Authority (**PRA**) and the FCA. ANZ is authorised in the United Kingdom by the PRA and is subject to regulation by the FCA and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request.

Fiji. For Fiji regulatory purposes, this document and any views and recommendations are not to be deemed as investment advice. Fiji investors must seek licensed professional advice should they wish to make any investment in relation to this document.

Hong Kong. This publication is issued or distributed in Hong Kong by the Hong Kong branch of ANZ, which is registered at the Hong Kong Monetary Authority to conduct Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities. The contents of this publication have not been reviewed by any regulatory authority in Hong Kong.

India. If this document is received in India, only you (the specified recipient) may print it provided that before doing so, you specify on it your name and place of printing.

Myanmar. This publication is intended to be general and part of ANZ's customer service and marketing activities when implementing its functions as a licensed bank. This publication is not Securities Investment Advice (as that term is defined in the Myanmar Securities Transaction Law 2013).

Important notice

New Zealand. This document is intended to be of a general nature, does not take into account your financial situation or goals, and is not a personalised adviser service under the Financial Advisers Act 2008 (**FAA**).

Oman. ANZ neither has a registered business presence nor a representative office in Oman and does not undertake banking business or provide financial services in Oman. Consequently ANZ is not regulated by either the Central Bank of Oman or Oman's Capital Market Authority. The information contained in this document is for discussion purposes only and neither constitutes an offer of securities in Oman as contemplated by the Commercial Companies Law of Oman (Royal Decree 4/74) or the Capital Market Law of Oman (Royal Decree 80/98), nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market Law (issued vide CMA Decision 1/2009). ANZ does not solicit business in Oman and the only circumstances in which ANZ sends information or material describing financial products or financial services to recipients in Oman, is where such information or material has been requested from ANZ and the recipient understands, acknowledges and agrees that this document has not been approved by the CBO, the CMA or any other regulatory body or authority in Oman. ANZ does not market, offer, sell or distribute any financial or investment products or services in Oman and no subscription to any securities, products or financial services may or will be consummated within Oman. Nothing contained in this document is intended to constitute Omani investment, legal, tax, accounting or other professional advice.

People's Republic of China (PRC). This document may be distributed by either ANZ or Australia and New Zealand Bank (China) Company Limited (**ANZ China**). Recipients must comply with all applicable laws and regulations of PRC, including any prohibitions on speculative transactions and CNY/CNH arbitrage trading. If this document is distributed by ANZ or an Affiliate (other than ANZ China), the following statement and the text below is applicable: No action has been taken by ANZ or any affiliate which would permit a public offering of any products or services of such an entity or distribution or re-distribution of this document in the PRC. Accordingly, the products and services of such entities are not being offered or sold within the PRC by means of this document or any other document. This document may not be distributed, re-distributed or published in the PRC, except under circumstances that will result in compliance with any applicable laws and regulations. If and when the material accompanying this document relates to the products and/or services of ANZ China, the following statement and the text below is applicable: This document is distributed by ANZ China in the Mainland of the PRC.

Qatar. This document has not been, and will not be:

- lodged or registered with, or reviewed or approved by, the Qatar Central Bank (**QCB**), the Qatar Financial Centre (**QFC**) Authority, QFC Regulatory Authority or any other authority in the State of Qatar (**Qatar**); or
- authorised or licensed for distribution in Qatar,

and the information contained in this document does not, and is not intended to, constitute a public offer or other invitation in respect of securities in Qatar or the QFC. The financial products or services described in this document have not been, and will not be:

- registered with the QCB, QFC Authority, QFC Regulatory Authority or any other governmental authority in Qatar; or
- authorised or licensed for offering, marketing, issue or sale, directly or indirectly, in Qatar.

Accordingly, the financial products or services described in this document are not being, and will not be, offered, issued or sold in Qatar, and this document is not being, and will not be, distributed in Qatar. The offering, marketing, issue and sale of the financial products or services described in this document and distribution of this document is being made in, and is subject to the laws, regulations and rules of, jurisdictions outside of Qatar and the QFC. Recipients of this document must abide by this restriction and not distribute this document in breach of this restriction. This document is being sent/issued to a limited number of institutional and/or sophisticated investors (i) upon their request and confirmation that they understand the statements above; and (ii) on the condition that it will not be provided to any person other than the original recipient, and is not for general circulation and may not be reproduced or used for any other purpose.

Singapore. This document is distributed in Singapore by the Singapore branch of ANZ solely for the information of "accredited investors", "expert investors" or (as the case may be) "institutional investors" (each term as defined in the Securities and Futures Act Cap. 289 of Singapore). ANZ is licensed in Singapore under the Banking Act Cap. 19 of Singapore and is exempted from holding a financial adviser's licence under Section 23(1)(a) of the Financial Advisers Act Cap. 100 of Singapore.

United Arab Emirates (UAE). This document is distributed in the UAE or the Dubai International Financial Centre (**DIFC**) (as applicable) by ANZ. This document does not, and is not intended to constitute: (a) an offer of securities anywhere in the UAE; (b) the carrying on or engagement in banking, financial and/or investment consultation business in the UAE under the rules and regulations made by the Central Bank of the UAE, the Emirates Securities and Commodities Authority or the UAE Ministry of Economy; (c) an offer of securities within the meaning of the Dubai International Financial Centre Markets Law (DIFCML) No. 12 of 2004; and (d) a financial promotion, as defined under the DIFCML No. 1 of 200. ANZ DIFC Branch is regulated by the Dubai Financial Services Authority (**DFSA**) ANZ DIFC Branch is regulated by the Dubai Financial Services Authority (**DFSA**). The financial products or services described in this document are only available to persons who qualify as "Professional Clients" or "Market Counterparty" in accordance with the provisions of the DFSA rules.

United States. Except where this is a FX- related document, this document is distributed in the United States by ANZ Securities, Inc. (**ANZ SI**) which is a member of the Financial Regulatory Authority (**FINRA**) (www.finra.org) and registered with the SEC. ANZSI's address is 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 9160 Fax: +1 212 801 9163). ANZSI accepts responsibility for its content. Information on any securities referred to in this document may be obtained from ANZSI upon request. This document or material is intended for institutional use only – not retail. If you are an institutional customer wishing to effect transactions in any securities referred to in this document you must contact ANZSI, not its affiliates. ANZSI is authorised as a broker-dealer only for institutional customers, not for US Persons (as "US person" is defined in Regulation S under the US Securities Act of 1933, as amended) who are individuals. If you have registered to use this website or have otherwise received this document and are a US Person who is an individual: to avoid loss, you should cease to use this website by unsubscribing or should notify the sender and you should not act on the contents of this document in any way. Non-U.S. analysts: Non-U.S. analysts may not be associated persons of ANZSI and therefore may not be subject to FINRA Rule 2242 restrictions on communications with the subject company, public appearances and trading securities held by the analysts. Where this is an FX-related document, it is distributed in the United States by ANZ's New York Branch, which is also located at 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 916 0 Fax: +1 212 801 9163).

Vietnam. This document is distributed in Vietnam by ANZ or ANZ Bank (Vietnam) Limited, a subsidiary of ANZ.

This document has been prepared by ANZ Bank New Zealand Limited, Level 26, 23-29 Albert Street, Auckland 1010, New Zealand, Ph 64 9 357 4065, e-mail nzeconomics@anz.com, http://www.anz.co.nz