

March 2021 Quarter CPI Review

21 April 2021



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Mixed signals

- Consumer prices rose 0.8% q/q in Q1 – slightly above our expectation, but weaker than the RBNZ’s forecast of a 1.0% q/q rise. In annual terms, the CPI rose 1.5%.
- Inflation is currently being supported by a number of factors that are likely to prove temporary. Higher oil prices and supply-chain disruptions have pushed up goods import prices and shipping costs, while the lack of migrant workers has led to higher-than-otherwise labour costs in some areas. This is likely to see inflation break above 2% over mid-2021, but we expect inflation pressures to ease once these drivers fade.
- It was always going to be a high hurdle for today’s data to shift the RBNZ from their ‘watch, worry and wait’ stance, and the details of this release are unlikely to challenge their view that ongoing stimulatory monetary policy settings will be needed to generate a sustained return to 2% CPI inflation and maximum sustainable employment.

Key points

The CPI increased 0.8% q/q in Q1, up from 0.5% in Q4. That’s a tad stronger than our forecast of 0.7% q/q, in-line with market consensus, and below the RBNZ’s February MPS forecast of 1.0%. In annual terms, inflation rose from 1.4% to 1.5% y/y. As we outlined in our [CPI preview](#) last week, it’s unlikely that the RBNZ will take much signal from what’s actually a pretty good quarterly number relative to historical Q1 CPI prints.

There are a lot of moving parts in the data. Supply chain disruptions have driven up import costs, and this has seen sky-high pricing intentions in our [Business Outlook](#) survey. But these disruptions won’t last for ever, and once supply chains adjust, cost pressures should ease.

The tight housing market has also pushed up consumer prices. Some of this looks temporary (with the industry grappling with temporary disruptions to imported goods and labour), and some of this looks more persistent, with higher rents a likely externality from recent [housing policy changes](#). We are expecting the housing market to cool over the rest of 2021, but rent inflation (which accounts for over 10% of the CPI basket), could stay elevated for a long while yet.

There were also a number of one-offs in the quarter, which have muddied the inflation picture. Oil prices rose sharply in Q1, which resulted in a 7.2% q/q rise in fuel prices. Overall, the transport group contributed 0.5ppts to the headline inflation figure, and the majority of this came from petrol prices, as well as higher prices for purchase of vehicles. While this strong outturn for the transport group did push the headline CPI figure slightly above our forecast, it’s a temporary driver, so won’t be a source of sustained inflation pressures.

Looking forward, we don’t think the details of today’s data present a meaningful challenge to our view that a lot of the building inflation pulse will prove temporary. However, the data remains rather noisy, and upside inflation risks exist as well as downside ones. Our central view is that headline inflation will break above 2% in mid-2021 before moderating late

Data summary

	% qtr	% ann
Headline CPI	0.8%	1.5%
Tradable	0.9%	0.5%
Non-tradable	0.7%	2.1%

in the year to sit below 2% for all of 2022 and into 2023. A key judgement underpinning this view is that potential GDP will recover rather quickly once borders reopen and global activity normalises.

We think the RBNZ will adopt a similar assessment, and that speaks to them watching and waiting for signs of sustainable inflationary pressures building before they begin to consider removing monetary stimulus from the economy.

Turning to the details

- Tradables prices rose 0.9% q/q, stronger than our forecast of 0.5%q/q, largely reflecting higher fuel prices. This saw annual tradables inflation rise from -0.3% y/y to 0.5%. Non-tradables inflation held steady at 0.7% (as expected), but that saw the annual figure fall to 2.1% y/y from 2.8% previously (as a very strong outturn in Q1 2020 drops out of the annual calculation).
- As expected, rising petrol and housing-related costs were a big driver of inflation this quarter (just slightly larger than we had estimated). Oil prices ticked-up strongly in Q1, which has seen domestic fuel prices rise 7.2% over the quarter. Meanwhile, the tight housing market saw home ownership costs rise 1.2% - the second strong quarter in a row. Rents increased 1.0% q/q – slightly stronger than the 0.8% implied by the monthly rent price index.
- Alcoholic beverages and tobacco increased just 1.6% in the quarter – much weaker than the usual increase. This reflects the end of the regular 10% annual tobacco excise tax hikes (see our [Preview](#) for more details).
- Core inflation measures gained momentum on a q/q basis, but slowed y/y on base effects. Prices as measured by the weighted median increased 0.8% q/q, and there was strength across every trimmed mean measure. Core measures should be treated with caution right now, as they could struggle to separate the temporary inflation drivers from what's a genuine signal about rising inflation momentum.

Market implications

For markets, today's data underscores the need for patience, as the RBNZ has been calling for, and should help anchor OCR expectations, and by extension, the short end of the yield curve. While it is difficult to envisage markets pricing out the risk of early OCR hikes entirely given widespread expectations that the next move in the OCR will be up, not down, even 50/50 odds of a 25bp hike next May (which is what is currently priced in) seems elevated, and we see scope for a further pullback in expectations over coming weeks.

The exchange rate is a key channel for inflation, and with other major global central banks also comfortably on hold it will be difficult for the RBNZ to "go it alone" and either hike early or adopt a hawkish tone – doing so risks driving up the NZD, and in turn, threaten to undermine a return to sustained inflation at the RBNZ's 2% inflation target.

Figure 1. Headline CPI inflation

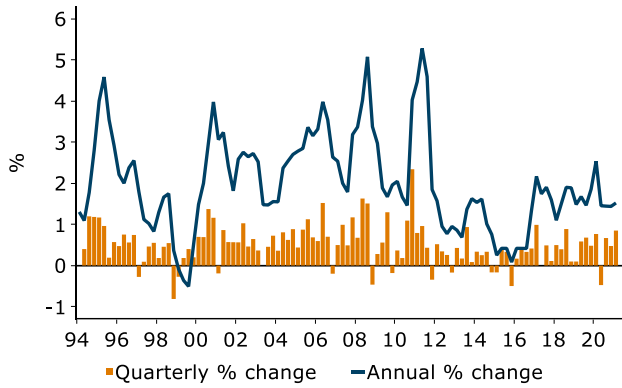


Figure 2. CPI inflation components

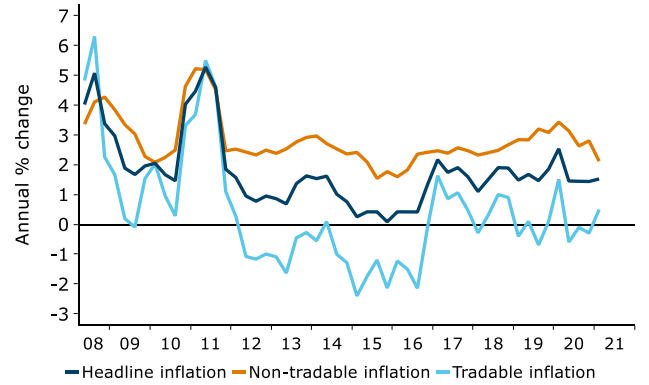


Figure 3. CPI groups – March 2021 quarter

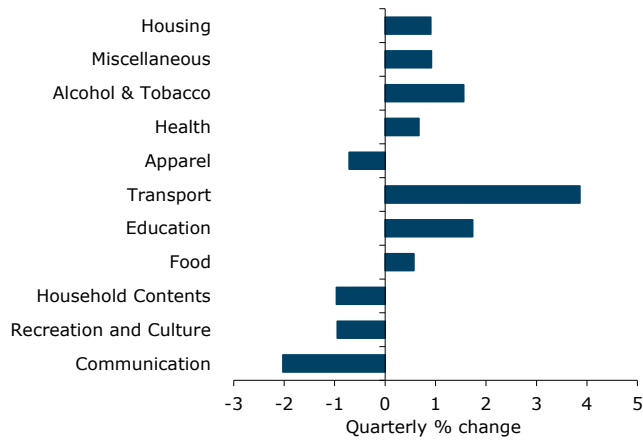
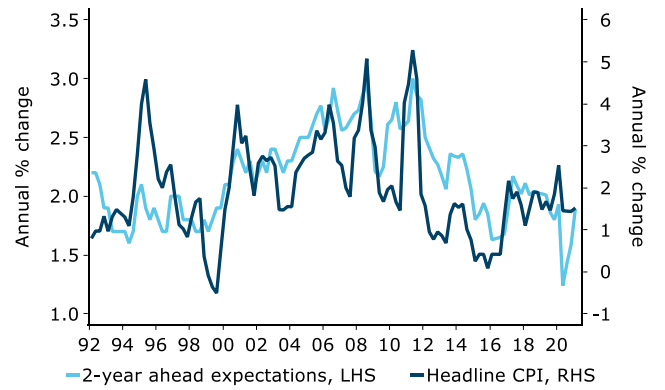


Figure 4. Inflation expectations & headline inflation



Source: Statistics NZ, RBNZ, Macrobond, ANZ Research



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