ANZ Research

June 2021 Quarter CPI Review

16 July 2021

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Contact

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Data summary

	% qtr	% ann
Headline CPI	1.3%	3.3%
Tradable	1.7%	3.4%
Non-tradable	1.2%	3.3%

Monstrous

- Consumer prices rose a massive 1.3% q/q in Q2, stronger than our expectation of a 0.9% lift (3.0% y/y). Annual CPI inflation rose to 3.3% - breaking through the top of the RBNZ's target band, and a post-2008 high (looking through the GST rise in 2010).
- There's a lot of noise still in the inflation data. The headline CPI figure in Q2 was pumped up by a higher minimum wage, strong oil prices, supply disruptions, and base effects (prices fell in Q2 2020, making the y/y% look very large). But, we're also seeing signs that sustained inflation pressures are building underneath all the noise, with the labour market tightening, and firms passing on higher costs to consumers.
- For the RBNZ, today's data marks the first time since before COVID that inflation was above the 2% midpoint. More importantly, measures of core inflation have headed in to the stratosphere – increasing to over 3% y/y in Q2. The RBNZ's Sectoral Factor Model, released at 3pm, should provide another view on core inflation pressure, but at this point, it's clear that inflation momentum is very strong. All up, this extremely strong data print absolutely confirms our view that the OCR will need to be lifted in August, given the economy is at risk of becoming dangerously overheated.

Key points

Consumer prices increased 1.3% q/q in Q2 2021 (3.3% y/y), stronger than our expectation of a 3.0% y/y rise, and miles above the 2.6% y/y peak the RBNZ was expecting in the May MPS. Non-tradables prices were up 1.2% q/q (3.3% y/y), and tradables prices were up 1.7% q/q (3.4% y/y). Overall inflation pressures are looking a lot stronger and more sustained than the RBNZ's previous forecast assumed. With the labour market likely close to full employment (the next update is on 4 August) and rising inflation expectations, it's unquestionably clear that interest rates need to rise to dampen down an overheating economy.

As we flagged in our Preview earlier in the week, there's still a lot of residual noise left in the data. For a start, the recent lift in the minimum wage to $20/hr has increased costs for firms – this often turns up quite strongly in the restaurant meals and ready to eat food category, where workers are more likely to be on the minimum wage. In the June quarter, this sub-group (which only accounts for just 5% of the CPI) added 0.2ppts to the headline CPI print. Higher oil prices have seen Kiwis facing higher prices at the pump, and supply disruptions are continuing to push up costs for firms.

While there is a lot going on in the data, with some of that being temporary, there is considerable underlying inflation momentum. And that's what matters for the RBNZ. The strong showing from the non-tradables side of things shows it's not just temporary supply issues or commodity price movements driving prices higher. Measures of core inflation also highlight that the underlying inflation pulse is building. Trimmed mean measures were 3.0-3.3% y/y (the RBNZ watches the 30% trimmed mean, which was up 3.0% y/y). The weighted median core inflation measure was up 3.0% y/y. And, CPI ex-food, energy and fuel was up 3.3% y/y. Now it's all eyes on the RBNZ's sectoral factor model of core inflation (out at 3pm). While there are a lot of temporary factors supporting prices at the moment, the sheer amount of momentum in the core inflation and non-tradables inflation measures confirms that inflation is here, it's strong, and the RBNZ has to respond to it as soon as possible.

Turning to the details

The actual drivers of inflation were what we expected, with food, transport, and housing contributing the bulk of the rise. They just contributed more than expected. Of the 1.3% quarterly increase:

- Housing added 0.5ppts to the headline inflation figure – a touch more than we had baked in. Home ownership costs rose 4.6% q/q - the most since the late 1980s, as a surging housing market and international supply disruptions cause costs to skyrocket. Rents were up 0.9% q/q, in-line with the rent price index.
- Food prices added 0.3ppts, with the higher minimum wage, tight labour market, and seasonality in fruit and vegetable prices pushing food prices up 1.5% q/q.
- The transport group added 0.3 ppts to the headline figure – stronger than we expected. Partly this reflected higher oil prices flowing through into petrol prices. But the ongoing disruption to the auto industry is also having an impact. With supply held back by chip shortages, and strong demand for cars in the US, surging prices for new and used cars added 0.1 ppts to headline CPI (a large chunk of the recent 5.4% y/y June inflation print in the US came from used vehicle prices spiking a whopping 45% in the year to June).
- International airfares were a key source of uncertainty during the quarter, with all trans-Tasman and Rarotonga routes added back into the CPI basket, and unseasonal price rises in Q1. On the day, international airfares fell 7.6% - remarkably close to our -8.0% pick, and knocking 0.1ppts off the headline inflation figure.

Monetary policy implications

We changed our OCR call to August in the wake of the Monetary Policy Review (MPR), where the RBNZ announced an end to the LSAP by July 23. In that release, the Monetary Policy Committee "agreed to reduce the current stimulatory level of monetary settings in order to meet its consumer price and employment objectives over the medium-term". The Committee now sees the balance of risks as having shifted, with the biggest regret now likely to be waiting too long to withdraw stimulus. We concur emphatically with that assessment, and today's data practically cements it – rate hikes are needed.

When we cut through the considerable noise in the data, it's clear that inflation momentum is building rapidly. The extremely tight labour market and shift in pricing behaviour by firms mean that the RBNZ can't afford to wait much longer – these factors will only help inflation snowball from here. Wednesday's MPR did acknowledge the risk of overshooting, but they've clearly still underestimated the degree of capacity stretch (and by extension inflation pressure) in the economy. The MPR was a further hawkish turn by the RBNZ, but relative to the almost-concerning strong inflation and employment data in recent months, it's already looking dated. The rise in core inflation measures over Q2 has cemented August as a necessary date for the OCR to lift off.

Figure1. Headline CPI inflation

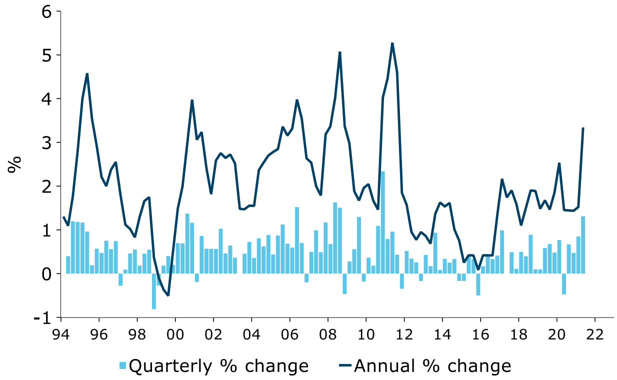


Figure 2. CPI inflation components

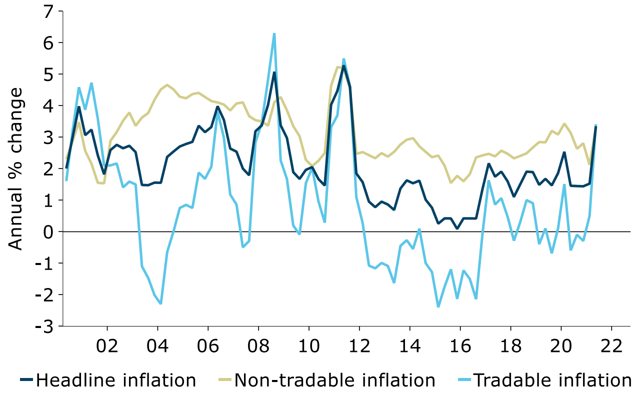


Figure 3. CPI groups – June 2021 quarter

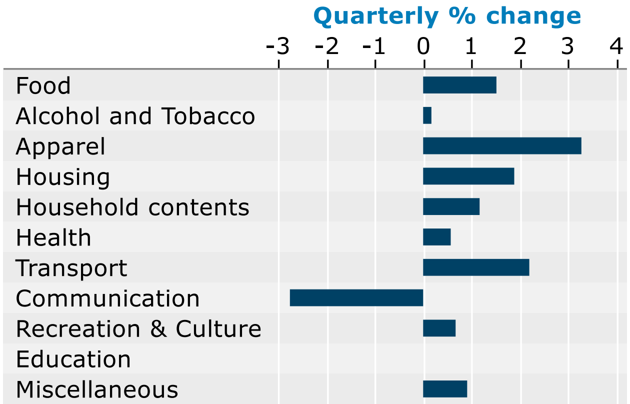
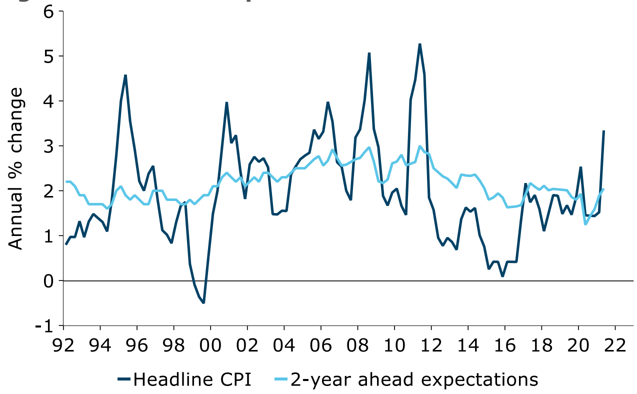


Figure 4. Inflation expectations & headline inflation



Source: Stats NZ, RBNZ, Macrobond, ANZ Research

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