ANZ Research

# September 2021 Quarter CPI Review

18 October 2021

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Contact

Finn Robinson or Sharon Zollner for more details.

Data summary

| | % qtr | % ann |
|---|---|---|
| Headline CPI | 2.2% | 4.9% |
| Tradable | 2.8% | 5.7% |
| Non-tradable | 1.8% | 4.5% |

## Purchasing power under attack

- CPI inflation was 2.2% q/q (4.9% y/y) in the September quarter, up from an already-strong 1.3% q/q (3.3% y/y) in June. That's a lot higher than the market median forecast of 4.2% y/y, and our forecast of 4.5% y/y. In fact, excluding the 2010 GST increase, that's the strongest quarterly increase in consumer prices since the 1980s!
- The data continues to be buffeted by a mix of temporary factors (eg oil prices and council rates rises) and more persistent drivers (eg supply chain disruptions). But there's clearly a very strong underlying inflation impulse coming through as well, with some measures of core inflation rising over 4% y/y in September.
- For the RBNZ, today's data will only reinforce that hiking the OCR in early October was the right move. Underlying inflation is too high, and further removal of monetary stimulus is needed to get things back on an even keel. With lockdown creating downside risks to employment and growth, uncomfortable trade-offs could quickly emerge. But with inflation this strong, the RBNZ won't want to play fast and loose with their inflation-targeting credibility.

### Key points

Consumer prices rose an eye-watering 2.2% q/q (4.9% y/y) in the September quarter, up from 1.3% q/q (3.3% y/y) in the June quarter. Tradables prices were up 2.8% q/q (5.7% y/y), while non-tradables inflation was 1.8% q/q (4.5% y/y). We had expected annual tradables inflation of 5.3%, and non-tradables of 4.1%. The latter increase will be most concerning for the RBNZ, since it represents strength in the domestic inflation impulse, which is harder to pin on temporary factors. Inflation is now markedly above the RBNZ's 1-3% target range, and while a lot of the increase in prices has been driven by temporary factors, there are now several indicators of core inflation with a 4-handle.

Consumers' purchasing power continues to be assailed from all directions. On the transitory side, surging petrol prices and an increase in council rates are boosting prices. With concerns about global energy shortages sending oil prices to a multi-year high in the first weeks of Q4, petrol prices may increase still further by the end of the year.

On the persistent (but not permanent) side, supply chain disruptions continue to plague the global economy. The US is resorting to operating its largest ports on a 24-hour basis just to clear the logjam of containers that is accumulating, and getting stock into stores for Christmas is going to be a real issue. With energy prices spiking and supply chain disruption facing off against Christmas demand, it's likely that imported inflation in particular (about 40% of the CPI basket) is going to get worse over the next few quarters.

As painful as these price rises are for Kiwi households, the RBNZ usually looks through this kind of inflation, so long as it remains temporary, and inflation expectations remain glued to the 2% midpoint of their inflation target. But what will be concerning is that several measures of core inflation now have a 4-handle, with CPI ex-food and fuel at 4.8% and 30% trimmed mean inflation at 4.0%. Weighted median inflation was a still-concerning

3.3%. These measures are probably overstating the degree of true ‘underlying’ inflation – they also spiked in 2010 when GST was increased. But they do unambiguously speak to the breadth of price increases, and it’s hard to escape the conclusion that the underlying inflation impulse right now is too strong to be consistent with the inflation side of the RBNZ’s dual mandate, which will likely see the Monetary Policy Committee more confident that further OCR hikes are needed.

## Turning to the details

Food, housing, and transport-related costs continue to be the big drivers of price rises, but there’s widespread strength across the CPI, with communication being the only group to see prices fall in the September quarter. Of the 2.2% q/q increase in consumer prices:

- Housing added 0.7ppts as rent prices continued to grind higher, and council rates were increased. Construction costs are still rising sharply, up 12% y/y in the September quarter, as shortages of materials and workers combine with record levels of building consents to create a pressure cooker for prices. The housing market is showing tentative signs of slowing down, but it’s a slow ship to turn.
- Food prices added 0.5ppts to headline. The monthly food price index has now posted six consecutive increases in a row – with prices rising in the month of September, which is usually when prices start to come off their seasonal peak. Domestically, the strength in food prices reflects acute labour shortages, the higher minimum wage, and higher seasonal price rises over winter. For imported food products, COVID-related disruptions and adverse weather events have both seen prices shooting up.
- Transport costs are up sharply again, adding 0.5ppts to inflation. Petrol prices are up 22% y/y, contributing 0.3ppts to headline. Petrol prices fell sharply in 2020, but demand has rebounded as countries start to relax COVID restrictions. In recent weeks, petrol prices have surged still further as concerns about energy shortages rise. Should prices keep lifting, that’ll only add to inflation pressure – and short-term inflation expectations – in Q4.

## Monetary policy implications

Today’s data will likely make the Monetary Policy Committee more certain that hiking the OCR in early October (with more to come) was the right move. The underlying inflation impulse is very strong. Our Business Outlook flash estimate for October showed that price and cost expectations remained near record levels; the QSBO posted a record level of capacity utilisation in Q3; and the labour market is likely still extremely tight, despite lockdown. There’s a lot of noise in the data, with a large contribution from supply disruptions, but underneath it all is an inflation gremlin that could easily get out of hand without continued action by the RBNZ.

We think that a series of gradual OCR hikes over the next year will be effective at constraining the domestic inflation impulse, but the risks are rising that inflation pressures become ingrained into price and wage setting, necessitating OCR hikes over and above the neutral interest rate to constrain the inflation overshoot. It’s worth noting that the RBNZ’s current forecast of a 2.1% OCR in 2024 already overshoots our assumption of neutral (1.5%), but the RBNZ’s neutral estimate is currently around 2%, so chances are that the November MPS will feature a higher endpoint to the OCR track.

As we’ve noted before, COVID is on balance a supply shock, which means it isn’t deflationary, despite being tough on the growth outlook. As lockdown drags on, downside risks to growth and employment are building, while inflation pressures worsen.

Early indications are that the labour market has been resilient so far, but if firms do have to start letting workers go, the RBNZ may have to make an uncomfortable trade-off between stabilising inflation and supporting employment.

Their preferred strategy would be to let inflation overshoot the target (via a lower-than-otherwise OCR), in order to stop employment falling too far below its maximum sustainable level. But in this highly inflationary environment, the RBNZ may be reluctant to risk inflation expectations becoming unanchored by letting inflation drift too high for too long. Assuming no sudden deterioration in the growth outlook (which remains a very real risk), OCR hikes into next year look like the least-regrets move given the risks around inflation. And while they are by no means a done deal, risks are building that even more OCR hikes could be needed to contain rising inflation.

## Markets

Markets reacted swiftly to the news, which was more about the brute strength of the headline rather than the details. For interest rate markets, it is less about the RBNZ will do next – which was already pretty obvious – and more about how much they may need to do in the future. Markets have moved to price in more OCR hikes in total, as opposed to bigger hikes over the near term. Not surprisingly, the 2yr swap rate rose by more than 10bps on the data.

The data also gave the NZD a boost, taking it above the 0.71 mark initially. Stagflation or a sustained period of high inflation and a de-anchoring of inflation expectations could potentially be very negative for the NZD if that were to eventuate, but that is not what we expect. Instead, we think inflation risks point to a higher-than-otherwise OCR, and that in turn likely speaks to a higher NZD so long as inflation expectations remain anchored, which we expect they will. We are also mindful that New Zealand is far from alone in experiencing an inflationary impulse, and that does potentially water down the way FX markets react to higher interest rates here.

(see charts over)

ANZ Research

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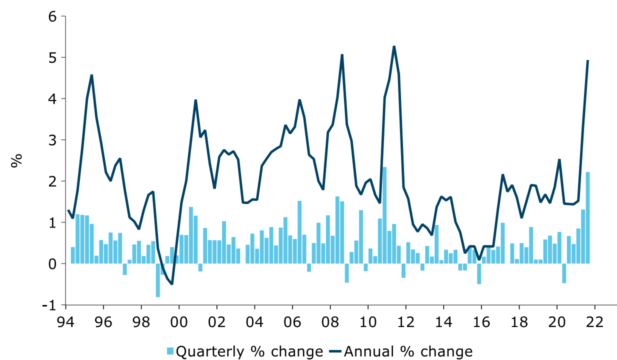
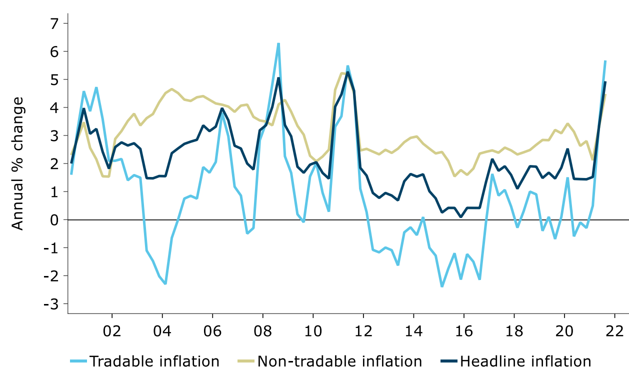
### Figure1. Headline CPI inflation



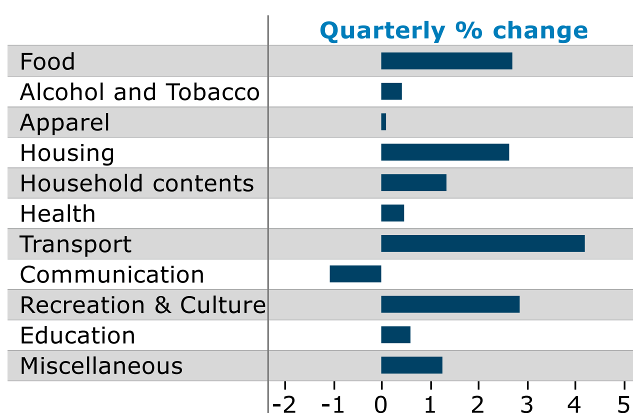

Source: Stats NZ, Macrobond, ANZ Research

### Figure 2. CPI inflation components



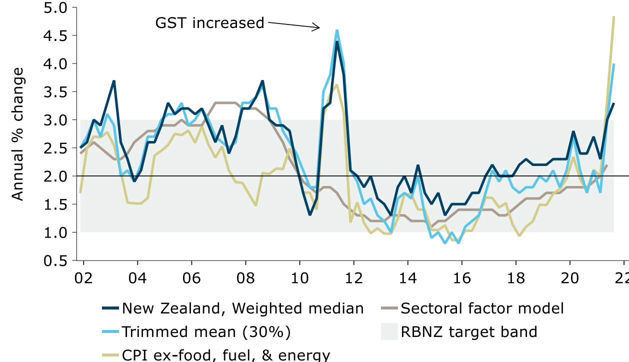

Source: Stats NZ, Macrobond, ANZ Research

### Figure 3. CPI groups – September 2021 quarter




Source: Stats NZ, Macrobond, ANZ Research

### Figure 4. Core inflation measures




Source: Stats NZ, RBNZ, Macrobond, ANZ Research

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

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