

## December 2021 Quarter CPI Review

27 January 2022



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## Contact

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## Cost of living crunch

- Consumer prices rose 1.4% q/q (5.9% y/y) in the December quarter, versus 2.2% q/q (4.9% y/y) in September. This marks yet another significant lift in the cost of living, which has been [squeezing Kiwi households](#) over the past year. The 5.9% print was slightly less than our 6.0% pick, but stronger than both market consensus (5.7%) and the RBNZ's November forecast (5.7%).
- Core inflation measures rose again in Q4, up between 3.8% and 5.4% y/y in the year to December 2021. It's yet another sign that inflation has well and truly moved beyond the "transitory" label that was being applied to it over early 2021. Inflation has some serious momentum.
- This CPI print reinforces the recent lift in our OCR forecast. Assuming none of the downside risks we're monitoring come to pass (which we fully acknowledge is a big assumption), then we think the OCR will [need to be lifted](#) to 3% by April 2023, up from our previous forecast of a 2% peak in August this year. Inflation is too strong, and it's seeping into every corner of the economy. Continued action is needed by the RBNZ to bring inflation back in line with their target – and that will require ongoing (and painful for some) rate rises even in a slowing economy.

## Key points

The cost of living accelerated again in the December quarter, with consumer prices up 5.9% y/y (1.4% q/q), versus 4.9% y/y (2.2% q/q) previously. The print was slightly less than our 6.0% forecast, but higher than market consensus (5.7%) and the RBNZ's November forecast for a 5.7% lift. As noted in our Preview, a 1.4% quarterly print for what's usually a seasonally weak quarter in the CPI is as much of an outlier as Q3's 2.2% quarterly print – highlighting how unusually strong inflation is at the moment.

Inflation is coming from all angles. We're importing plenty of it, with tradables prices up 6.9% y/y (vs our forecast for 7.6%). Disruption to global supply chains is coming on top of domestic inflation pressures like rising labour costs and ongoing restrictions due to the health response to COVID-19 – sending tradables prices sky high. For context, annual tradables inflation averaged just 0.1% from 2010 to 2019.

The domestic economy is also highly inflationary – and this is the real issue for the RBNZ. Non-tradables inflation lifted to 5.3% y/y (vs our forecast for 5.1%) – again demonstrating that inflation has spread from a few transitory factors related to the pandemic, into a broader surge in prices across the consumption basket. Measures of core inflation rose again, now sitting between 3.8% and 5.4% y/y. The biggest surprise in today's data was how much of the inflation pressure is now coming from the domestic economy – with non-tradables coming in hot, while tradables was quite a bit below our forecast (albeit still very strong).

These are troubling numbers for a central bank that has only just embarked on its hiking cycle – even if the RBNZ has been quicker than many international peers to recognise the change in the wind and raise rates. There's more work to do in order to bring the surging domestic inflation impulse under control – and that will weigh on an economy that's already struggling to grow in the face of ongoing COVID disruption.

### Data summary

	% qtr	% ann
Headline CPI	1.4%	5.9%
Tradable	1.3%	6.9%
Non-tradable	1.5%	5.3%

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## The details

Inflation pressures remain broad-based. Of the 1.4% q/q increase in consumer prices in the December quarter:

- Construction costs added 0.4 ppts, reflecting ongoing cost pressures in the construction industry. House prices may be [on the decline](#) as we head into 2022, but there's so much building work in the pipeline that cost pressure won't ease any time soon. Construction costs were up 15.7% on an annual basis – far ahead of the increase in the overall CPI.
- Transport costs contributed 0.5ppts to headline, with the bulk of the increase coming from a 7.7% lift in petrol prices. Prices at the pump are now up 30.5% over the past 12 months, reflecting ongoing rises in global oil prices, as well as NZD weakness. Petrol prices are hardly "core" inflation, but they tend to have an outsized impact on consumer inflation expectations, which in today's context is problematic.
- Food prices subtracted 0.1ppts from the headline print, reflecting the usual seasonal declines in fresh produce. Despite the fall, food prices have actually been much stronger than usual in Q4 – the annual rate of food price inflation accelerated to 4.1%, versus 3.1% in Q3.
- Global inflation pressures remain intense – and with tradable items making up just under 40% of the CPI, imported inflation is still having a sizeable impact on the cost of living. For example, household contents and services added 0.1ppts, while recreation and culture added 0.2ppts, reflecting increases in imported components within those groups.

## Monetary policy implications

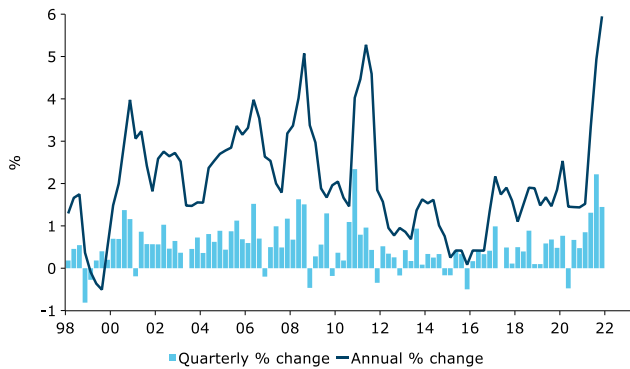
Today's data [reinforces our call](#) last week that the OCR will need to be lifted from its current 0.75%, all the way to 3% in April 2023. Growth risks are to the downside as the housing market slows, business and consumer confidence look vulnerable, and Omicron hits both demand and supply, but inflation is on a tear. And high inflation itself is bad for growth. It's challenging for households – especially if you're a [low income household](#). Basic necessities are surging in price, while real wages are falling as pay rises lag behind inflation.

The biggest concern for the RBNZ right now is the feedback loop between surging inflation and an extremely tight labour market (we'll get Q4 data for that next week – expect further strength). COVID has been a negative productivity shock – which means that even as firms pay higher and higher wage bills, they're actually likely getting less output per worker. That gives them two options: absorb higher costs in their margins (that can't last forever), or pass them onto consumers. The latter is what has happened over the past few quarters. But with living costs rising, workers will demand compensation. And in a labour market this tight, they're more likely to get it (either from their current employer, or by [jumping ship](#)). And then the cycle repeats. What's worse, is that even though wages will grow quickly, those gains will be rapidly outstripped by rising inflation.

This 'wage-price-spiral' is just getting going – but should it gain momentum, then subduing the wide-awake inflation dragon without causing a hard landing along the way will become a very challenging prospect.

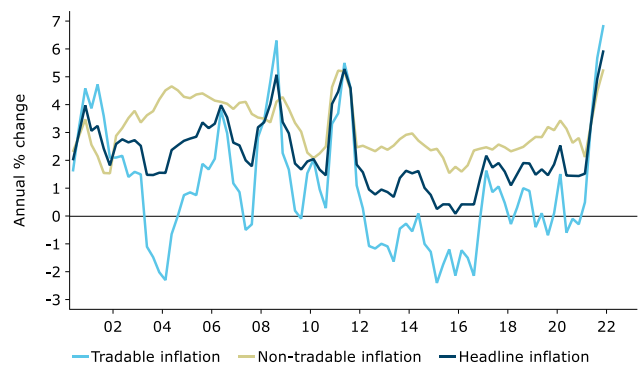
There is clearly a lot of work for the RBNZ to do to control inflation. They have a head start relative to other central banks (some are still actively buying assets as part of their quantitative easing programs). But it's still a long and arduous journey back to low and stable inflation, with plenty that could go wrong along the way.

**Figure 1. Headline CPI inflation**



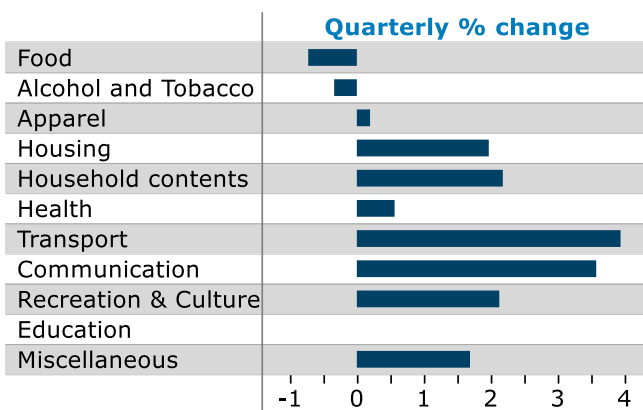
Source: Stats NZ, Macrobond, ANZ Research

**Figure 2. CPI inflation components**



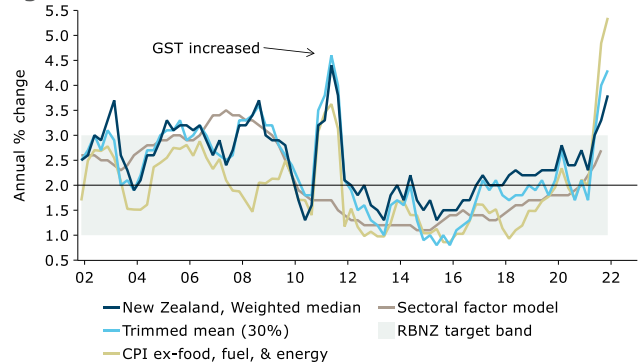
Source: Stats NZ, Macrobond, ANZ Research

**Figure 3. CPI groups – December 2021 quarter**



Source: Stats NZ, Macrobond, ANZ Research

**Figure 4. Core inflation measures**



Source: Stats NZ, RBNZ, Macrobond, ANZ Research



## Contact us

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